

SELWYN DECLARATION

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

Application by Verizon New Jersey,
Inc., Bell Atlantic Communications,
Inc. (d/b/a Verizon Long Distance),
NYNEX Long Distance Company
(d/b/a Verizon Enterprise Solutions),
Verizon Global Networks Inc., and
Verizon Select Services Inc. for
Authorization to Provide In-Region,
InterLATA Service in New Jersey

CC Docket No. 01-347

Declaration

of

LEE L. SELWYN

on behalf of

AT&T Communications of New Jersey, Inc.

February 28, 2002

DECLARATION OF LEE L. SELWYN

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DECLARATION OF LEE L. SELWYN

1 Introduction and Summary

2

3 Lee L. Selwyn, of lawful age, declares and says as follows:

4

5 1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc.
6 ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and
7 consulting firm specializing in telecommunications and public utility regulation and public
8 policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part
9 hereof.

1 2. I have participated in proceedings before the Federal Communications Commission
2 (“FCC” or “Commission”) dating back to 1967 and have appeared as an expert witness in
3 hundreds of state proceedings before more than forty state public utility commissions. I have
4 submitted testimony in several Section 271 consultative proceedings, including those in
5 Pennsylvania, California and Minnesota, as well as in the New Jersey state and FCC
6 proceedings.

7
8 3. In its February 1, 2002 *Reply Comments* in this matter, Qwest cites a “new study” by
9 Jerry A. Hausman and J. Gregory Sidak (“Hausman/Sidak study”) that, according to Qwest,
10 “suggests that it will be the poorest and least educated customers who will suffer the most”
11 from the February 1, 2002 increases in “basic rates” initiated by the “big three” IXC’s. I have
12 been asked by AT&T to review the Hausman/Sidak study¹ and to analyze the various
13 assertions being advanced and assumptions being relied upon by the authors as the basis for
14 their contentions that there are “strong relationships between the price per minute and the
15 customer’s income and level of education” and that the IXC’s have adopted “a pricing strategy
16 [that] facilitates price discrimination against a segment of consumers who are reluctant to
17 switch from branded, nondiscounted MTS.” In this Declaration, I show that the authors’
18 various assertions and assumptions are demonstrably false, and that the “econometric
19 analysis” that the authors present, in addition to being entirely undocumented and
20 nonreplicable, fails even on its face to support the hypothesized price/income/education

21 1. Jerry A. Hausman and J. Gregory Sidak, “Do Long Distance Carriers Price Discriminate
22 Against the Poor and the Less-Educated?,” unpublished, January 2002, available at
23 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296368

1 relationships, let alone the existence of “third-degree price discrimination” by the “big three”
2 interexchange carriers.

3
4 4. Qwest also contends that “the long-distance market today remains so concentrated that
5 Bell company entry remains necessary to drive consumer rates down to cost.” Qwest offers
6 no facts or quantitative evidence to support this contention. In fact, there are hundreds of
7 long distance companies offering services at retail to consumers, *no single one of which*
8 *currently controls more than about 38% of the residential long distance market.*² According
9 to the most recent (January 2001) FCC *Trends in Telephone Service* report, the *combined*
10 *market share* for AT&T, WorldCom and Sprint (Qwest’s “big three”) is only about 69.5%, or
11 about 65% when ILEC shares are included.³ Last year, Verizon asked the New Jersey Board
12 of Public Utilities (“BPU”) to deregulate its multiline business services, on the basis that
13 “substantial competition for local business services is present throughout Verizon NJ’s service
14 area.”⁴ Yet by Verizon’s own count (which is, if anything, exaggerated), CLECs currently
15 serve only about 11% of New Jersey business lines via resale, UNEs, and facilities-based

16 2. FCC Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*,
17 August 2001, at Table 10.8. When ILECs and CLECs are included in addition to IXC’s, the
18 largest single company share decreases to 35.2%. Table 10.9.

19 3. *Id.*

20 4. *In the Matter of the Application of Verizon New Jersey, Inc. For Approval of (i) of a*
21 *New Plan for an Alternative Form of Regulation, and (ii) to Reclassify Multi-line Rate*
22 *Regulated Business Service as Competitive Services, and Compliance Filing*, New Jersey BPU
23 Docket No. TO01020095, Panel Testimony of Harry M. Shooshan, Joseph H. Weber, and
24 William E. Taylor, February 15, 2001, at 40.

1 services, leaving Verizon with a whopping 89% (or more) of this market.⁵ Juxtaposing the
2 69.5% *three-firm* share for the long distance market that Qwest claims to be “concentrated”
3 against Verizon’s *one-firm* 89% share of the New Jersey multiline business market that
4 Verizon portrays as demonstrating “substantial competition,” to describe Qwest’s claim
5 merely as being disingenuous would be extraordinarily charitable.

6

7 5. In yet another unpublished Hausman/Sidak “study,” the authors advance this same
8 contention — that BOC entry into long distance lowers prices and benefits consumers. As I
9 shall demonstrate below, this “conclusion” is based upon a seriously misspecified
10 “econometric model” that omits numerous explanatory variables — most particularly the
11 switched access price level — and that selectively compares price changes in the first two
12 “271 states” — New York and Texas — with those in two other “control states,” selected by
13 the authors, in which rate reductions over the corresponding time period happen to have been
14 less than in the two “271 states.” Yet in other non-271 jurisdictions, long distance rates
15 actually fell by considerably more than in New York and Texas; had these been used as the
16 “control” states, *precisely the opposite conclusion as to the “benefits” of BOC entry would*
17 *have been demonstrated.*

18

19 5. According to Verizon New Jersey, E911 listings data, which the Company proffers as
20 being indicative of facilities-based and UNE-based loops, show that CLECs were serving “at
21 least 220,500 voice lines with their own facilities by January 17, 2001,” and an additional
22 110,573 business lines were served by CLECs on a resold basis (as of November, 2000). On
23 a consolidated basis, CLECs served 11% of the 2.9-million business access lines in New
24 Jersey. *Id.*, at 44; ARMIS 43-08, Table III, “Access Lines In Service by Customer, 2000.”

1 **Hausman/Sidak's contentions that long distance companies discriminate against the poor**
2 **and less-educated are based upon a seriously flawed "econometric model" and are**
3 **contrary to the facts.**
4

5 6. Actual market facts do not support Hausman/Sidak's entirely theoretical claims. If
6 IXC's were engaging in "third-degree price discrimination" against the poor and less-educated,
7 as the authors assert, we would expect to see substantially more low-income customers taking
8 the basic (non-discounted) rate than for higher-income customers. However, this outcome is
9 not supported by actual AT&T data, which not only show that the income and age distri-
10 butions of AT&T's basic rate plan and discount calling plan customers are nearly identical,
11 but that those distributions are substantially identical to the population as a whole (see
12 Attachment 2). Were "discrimination against the poor" actually taking place as Hausman and
13 Sidak surmise, one would expect to see more low-income households taking basic service
14 than the incidence of such households in the population overall. In fact, the under-\$20,000
15 income households represent 22.61% of all US households,⁶ yet constitute only 17.4% of
16 AT&T's basic rate subscribers.

17

18 7. The structure of long distance pricing reflects the effects both of fixed, account-
19 sensitive and of costs that vary with the total volume of usage. Low-volume users are
20 charged more per call or per minute than heavy users because carriers must recover those
21 fixed, account-sensitive costs across a smaller calling volume. *It is only when a poor or less-*

22 6. *Annual Demographic Survey*, March Supplement, Current Population Survey, United
23 States Bureau of Labor Statistics and United States Bureau of the Census, issued Dec. 13,
24 2001, Table HINC-01.

1 *educated consumer is also a low user of long distance service that the price will be relatively*
2 *high, as it also would be for a low-volume, high-income and highly educated customer.*
3 *Hausman/Sidak offer no data or evidence that would suggest any correlation between*
4 *income/education, on the one hand, and monthly long distance usage, on the other. Yet*
5 *even though total household calling volume is without question the single most important*
6 *determinant of the average price that consumers are charged for long distance calls and this*
7 *data was available to the authors in the “bill harvesting” data they used for their “study,” this*
8 *key element was excluded from the “econometric model” that the authors offer as evidence of*
9 *their “third-degree price discrimination” claim. The deliberate omission of this critical data*
10 *forces the econometric model to look for “other” causes, such as income and education, and*
11 *to offer entirely spurious “explanations” for variations in price on the basis of these otherwise*
12 *unrelated factors.*

13

14 8. If Hausman/Sidak's theory was correct that low-income, less-educated customers do
15 not shop for the best long distance rates, then one would expect that AT&T, as the oldest
16 long distance company with the largest number of “legacy” residential customers, would have
17 the highest percentage of “basic rate plan” customers among the major IXC's. In fact,
18 however, *according to Hausman/Sidak's own data*, AT&T actually has the *lowest* percentage
19 of basic rate customers – 42% – whereas 60% of Sprint's customers and 45% of MCI's
20 customers are on those carriers' basic rate plans.⁷

21

22 7. Hausman/Sidak, at 13.

1 9. Each year, some 30-million or more residential customers *change* their long distance
2 company⁸ and another 17-million more move their principal residence and are thus afforded
3 an opportunity to select a new long distance company when they order their *local* phone
4 service.⁹ These facts soundly refute Hausman/Sidak's claim¹⁰ that "long distance customers
5 display strong brand loyalty," which they then claim "contributes to a divergence in
6 willingness to pay." Moreover, this phenomenon cuts across all income and education
7 groups, and Hausman/Sidak offer no evidence whatsoever that the poor and less-educated
8 display any greater "brand loyalty" than do other customers.

9

10 10. That the poor and less-educated are particularly cost-conscious when it comes to
11 long distance service is further confirmed by a study of the demand for prepaid phone cards
12 that was conducted by the very same company – TNS Telecoms – that compiled the
13 "customer bill harvesting" data upon which Hausman/Sidak rely. That study¹¹ showed that
14 the demand for prepaid calling cards and prepaid wireless services was *greatest* among the
15 poor and less-educated. The Hausman/Sidak study did not even consider service alternatives
16 such as prepaid phone cards, prepaid cellular phones, and dial-around services, all of which

17 8. "J.D. Powers and Associates Reports: Sprint and SNET Top Performers in Residential
18 Long Distance Customer Satisfaction," July 29, 1999.

19 9. U.S. Census Bureau, American Housing Survey for the United States in 1999, Table
20 2.9.

21 10. Hausman/Sidak, at 8.

22 11. TNS Telecoms, *Market Monitor 2000: PrePaid Calling Cards and PrePaid Wireless*,
23 Indetec International, Inc., 2000.

1 are disproportionately used by the very group that Hausman/Sidak claim are the object of
2 price discrimination by the IXCs. The same TNS Telecoms study also reveals the lack of any
3 consistent correlation between income level and usage of (wireline) long distance services, but
4 does indicate that *cellular usage* is actually higher among the under-\$15,000 annual income
5 level customer group than for customers in the \$15,000 to \$75,000 income range.

6
7 11. Low-income customers are willing and able to make complex pricing decisions
8 concerning purchases of complicated goods, such as computers and automobiles. There is no
9 reason to believe that they will not do the same for long distance service purchases.
10 Hausman/Sidak's insinuation that low income customers and customers who are not highly
11 educated do not shop for the best value in long distance service — an assertion that has no
12 support whatsoever either in their data or in their econometric analysis — is devoid of factual
13 basis and is demeaning to those customers.

14
15 12. In fact, low-income customers and customers who are not college educated are
16 certainly not information deprived where long distance pricing and calling plans are
17 concerned. These customers receive competitive pricing information daily at no cost from
18 television advertising, radio advertising, billboards, newspaper ads, direct mail, and the
19 Internet, all paid for by competing long distance carriers.

20
21 13. Hausman/Sidak contend that “long-distance pricing is obscure” because “carriers
22 generally do not report the complete schedule of long-distance prices to the customer” and go

1 on to argue that cellular pricing is less complex. This claim is utterly baseless. Cellular rate
2 structures (including and especially those being offered by BOC-affiliated cellular carriers) are
3 extraordinarily complex. Besides the monthly fee/calling allowance tradeoff (which also
4 exists for long distance pricing plans), to make an accurate decision on the “best” cellular
5 pricing plan the customer will need to consider, in addition to total calling volume, such
6 factors as the mix of on-peak and off-peak calling, the mix of “home” vs. “roaming” use and
7 for roaming, the geographic area within which such roaming is likely to occur, the mix of
8 local vs. long distance use, the mix of incoming vs. outgoing use, and the mix of usage in
9 “digital” service areas vs. analog (800 Mhz) service areas. Yet Hausman/Sidak do not
10 suggest that the poor and less-educated are encountering any particular difficulty in buying
11 cellular services nor do they chastise the BOC-affiliated wireless carriers for creating such
12 complexity in their own pricing.

13

14 14. BOC long distance pricing is certainly anything but simple. Verizon Long Distance,
15 for example, offers a range of pricing options differing as to their treatment of peak and off-
16 peak use (some plans offer the same rate at all times, others differentiate), the presence or
17 absence of a monthly fee, and the pricing of in-state vs. interstate calls. Deciding among
18 these alternatives is not easy, even for the well-educated. Consider, for example, two of the
19 pricing options currently being offered by Verizon Long Distance both in New York and in

- 1 Massachusetts — the “Best Times” and “State Saver” plans. Both carry the same \$4.75
- 2 monthly fee, but differ in their respective usage charges:

Table 1				
Verizon Long Distance Residential Calling Plans New York and Massachusetts				
Plan	"Best Times"		"State Saver"	
Monthly Fee	\$4.75		\$4.75	
State-to-State calls	Mon-Fri, 8am-5pm	\$.07	All times	\$.09
	Other times	\$.05		
Within Massachusetts	Mon-Fri 8am-5pm	\$.05	All times	\$.07
	Other times	\$.07		

- 1 There is, in fact, *no circumstance in which Verizon's "State Saver" plan is a less expensive*
- 2 *choice than the "Best Times" plan*, and unless the customer makes *only* intrastate calls and
- 3 makes them *only* during the peak (Mon-Fri, 8am-5pm) rate period (in which case the total
- 4 charge under either plan will be the same), the “State Saver” plan will *always* be more
- 5 expensive. Yet on its website, Verizon describes the “State Saver” plan as “Best for people
- 6 who want very low in-state rates.” In fact, the “State Saver” plan is *never* “best” for
- 7 anybody; at most it is “just as good” as the other \$4.75-a-month “Best Times” plan for that
- 8 improbable customer who makes at least 158 minutes worth of peak-period intrastate calls
- 9 each month but who *never* makes *any* off-peak or interstate calls at all! In Massachusetts,

1 Verizon New England offers a \$.05 intraLATA toll discount plan (“Sensible Minute (TM)”)
2 to its local service customers with no monthly fee or minimum calling allowance. So if a
3 Verizon Massachusetts customer who places a large number of intraLATA calls were to
4 follow the recommendation of the Verizon website and select the “State Saver” plan for *all*
5 intrastate calling (intraLATA and interLATA) because Verizon describes it as “Best for
6 people who want very low in-state rates,” the customer would end up paying \$.07 instead of
7 \$.05 per minute for intraLATA calls.

8
9 15. SBC’s long distance offerings are different from Verizon’s, but also require that the
10 customer undertake a good deal of careful analysis in order to make the correct least-price
11 choice (see Table 2). Under SBC’s pricing structure, the “break-even” point between the
12 “SBC Domestic Saver” and “SBC Long Distance” plans is 165 minutes, which would cost
13 \$16.50 under either plan. The “SBC Domestic Saver” plan produces the lowest price for
14 usage levels between 165 and 186 minutes per month. The “Block-of-Time 300 Minute” plan
15 is best for usage between 187 and 415 and above 1005 minutes; the “Block-of-Time 500
16 Minute” plan is best for usage between 415 and 1005 minutes (see Figure 1). Of course, if
17 the customer’s usage level varies from one month to the next and crosses any of these plan
18 boundaries, the total charge to that customer will be higher than under the “best” plan that
19 might have applied for that particular billing period. In that regard, the “SBC Domestic
20 Saver” plan would almost never be the best choice, unless the customer can predict — with
21 considerable precision — that her monthly usage will *consistently* fall within the extremely

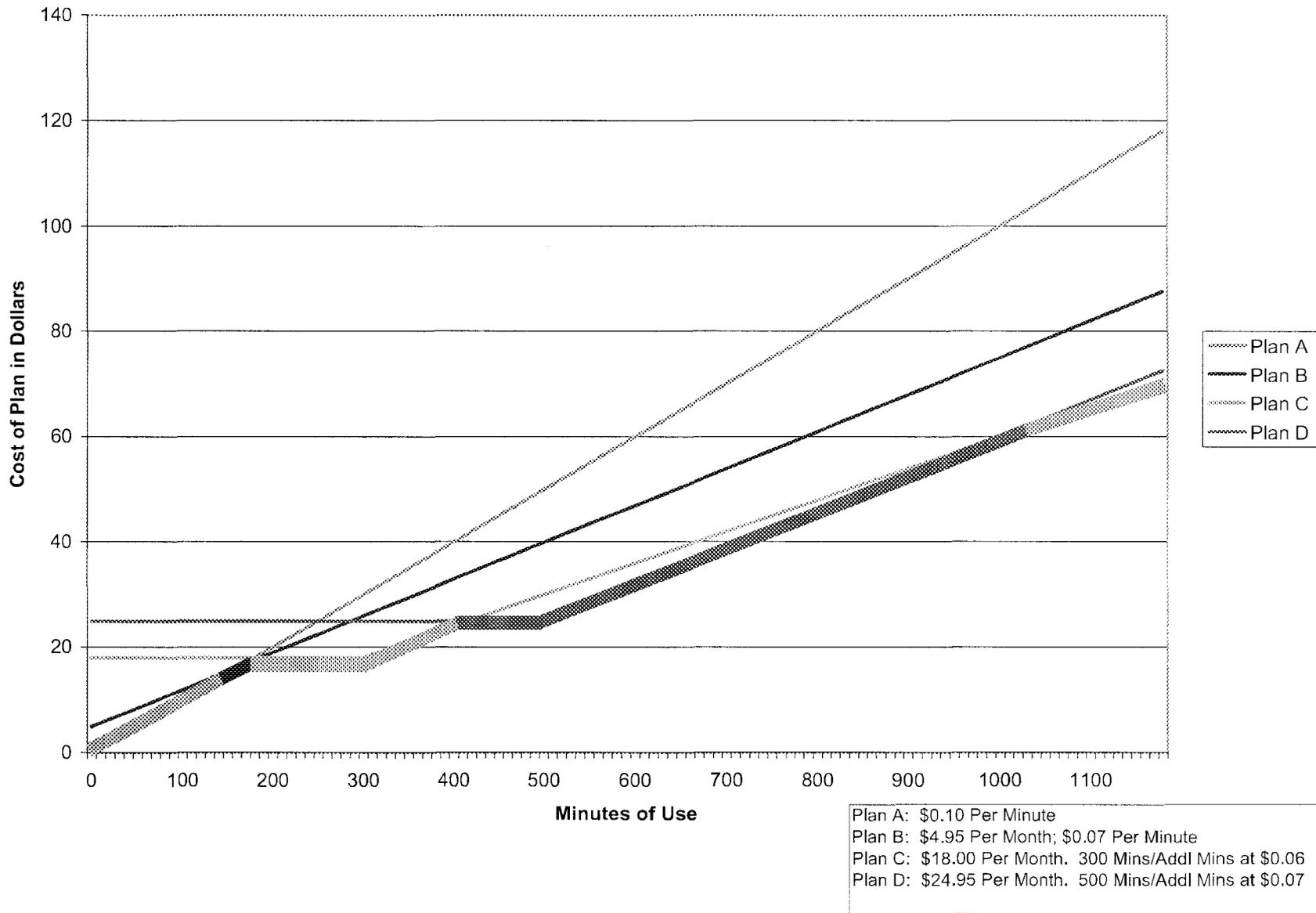


Figure 1: The complex structure of SBC Long Distance Calling Plans makes picking the best one extremely difficult

- 1 narrow 166-to-186 minute "window" where the average price per minute under this plan is
- 2 lower than for any other SBC long distance pricing option.

Table 2				
SBC Long Distance Residential Calling Plans				
Plan	SBC Domestic Saver	SBC Long Distance	Block-of-time 300 minutes	Block-of-time 500 minutes
Monthly fee	\$4.95	\$0.00	\$18.00	\$24.95
Included minutes	0	0	300	500
Charge per additional minute	\$.07	\$.10	\$.06	\$.07

1

2 16. Qwest's own pricing of residential long distance service in its out-of-region states is,

3 in many respects, even more complex and arcane than Verizon's and SBC's *in-region* pricing

4 practices. For example, Qwest offers a block-of-time plan it calls "Qwest 250" in which the

5 customer gets up to 250 minutes of *interstate* calling per month for \$9.95, with additional

6 usage billed at \$.07 per minute. In-state calls are *not* included in this block of time, and are

7 billed separately. Alternatively, the customer can take the "Qwest 200 Plan" at \$14.95 per

8 month, which provides for up to 200 minutes of interstate and intrastate calling *combined*,

9 with additional minute charges of \$.07 for interstate calls and various (usually higher) charges

1 for in-state calls, depending upon the state. Not only will the customer need to carefully
2 analyze his usage pattern, but for the “Qwest 200 Plan” if total usage exceeds the 200 minute
3 allowance, the total monthly bill, for the same number of total minutes, could nonetheless
4 vary if, for example, the in-state calling occurs toward the end of the month rather than at the
5 beginning of the month, when the higher rate in-state calls would be included within the
6 monthly allowance. Adding to the complexity of its rate plans, Qwest also offers a “5¢
7 Calling Plan” with a monthly fee of \$3.95 plus \$.05 per minute for interstate calls, and a “6¢
8 Calling Plan” with no monthly fee but with a \$10 minimum charge, \$.06 a minute for
9 interstate calling, and \$.10 a minute for in-state and “local toll” (intraLATA) calls.

10

11 17. It is not my purpose here to discuss the relative merits of this type of pricing, but in
12 view of the BOCs’ own long distance pricing practices, Qwest’s — and Hausman/Sidak’s —
13 suggestion that BOC entry will somehow “improve” the ability of low-income and less-
14 educated consumers to make intelligent choices among their various long distance alternatives
15 would be laughable if it were also not so ludicrous. There is simply no factual *or even*
16 *inferential* basis for Hausman/Sidak’s — and Qwest’s — claim that, following BOC long
17 distance entry, those same customers who, they allege, do not currently price shop for long
18 distance service, will suddenly *begin to price shop* for these services once they are offered by
19 BOCs.

20

1 18. There is simply no basis for Hausman/Sidak's conclusion that the poor and less-
2 educated do not price shop for long distance service, and the inference that they will not price
3 shop unless and until the RBOCs are permitted into long distance is thus wholly meritless.

4

5 **The Hausman/Sidak “econometric model” and the economic “assumptions” upon which**
6 **it is based do not meet even the most minimal standards of a valid economic analysis.**

7

8 19. At the outset and as a threshold matter, even a cursory examination of the
9 Hausman\Sidak regression model leads inescapably to the conclusion that the model is
10 woefully misspecified and as such fails entirely to demonstrate the income/education vs. price
11 relationship that the authors assert.

12

13 20. Prior to the entry of competition in the long distance market, *no discount plans or*
14 *declining block rate structures were offered to residential customers*; customers paid exactly
15 the same usage charges whether they made one call or a hundred calls a month. Competition
16 is expected to drive prices to cost, and the per-minute cost decreases as the total volume of
17 usage by a customer increases. The current pricing practices — practices driven by the
18 presence of intense competition in the long distance market — reflect this fundamental cost
19 attribute. In advancing their “discrimination” theory and in constructing their results-driven
20 regression model, Hausman/Sidak ignore entirely the cost structure of the long distance
21 market and the intense competition that has produced a pricing regime reflective of those cost
22 conditions.

23

1 21. Hausman/Sidak *assume* — without so much as a single shred of evidence or support
2 — that the “marginal cost” is the same for all types of long distance customers at all usage
3 level. *Yet that critical assumption lies at the core of the Hausman/Sidak “discrimination”*
4 *contention.* The authors state:

5
6 According to its proper economic definition, price discrimination occurs when consumer
7 *A* pays a firm a different price for a particular good than consumer *B*, even though the
8 marginal cost of producing the good is the same for both consumers.
9

10 Of course, “the marginal cost of producing the good” — long distance calls in this case — is
11 distinctly *not* the same for all consumers. Factors influencing cost include the total volume of
12 calling over which customer account-sensitive costs are to be recovered, marketing costs,
13 billing and billing inquiry costs, uncollectibles, and perhaps others. Hausman/Sidak offer no
14 factual support whatsoever for this critical pillar of their argument — that the marginal cost
15 of all long distance calls is the same and that it is not affected by, in particular, the total
16 volume and time-of-day distribution of calls placed by a given customer.

17

18 22. The purpose of any econometric model is to test the validity of an hypothesized
19 relationship. The model can only test relationships between the “dependent variable” (average
20 price per minute, in this case) and those “explanatory” variables that are included in the
21 model specification. Additionally, regression analysis is capable of identifying and
22 quantifying *correlations* among variables, *but cannot by itself ascribe or attribute causality to*
23 *the relationships that it identifies.* For this reason, it is incumbent upon the modeler to
24 include among the explanatory variables *all factors* for which there is at least an intuitive

1 basis to expect a causal relationship. Omission of one or more such sources of variation in
2 the dependent variable will result in spurious mis-attribution of causality to other explanatory
3 variables. In the instant case, Hausman/Sidak *hypothesize* a deliberate strategy on the part of
4 the large IXCs to “discriminate” against certain customers and customer groups, and test this
5 theory by regressing the average revenue per minute (the “price” variable) against the
6 demographics of age, education and income. Incredibly, and even though *total household*
7 *calling volume* is without question the *single most important determinant* of the average price
8 that consumers pay for long distance calls and was *available* in the “bill harvesting” data used
9 by Hausman/Sidak, this key element was *excluded* from the “econometric model” that the
10 authors claim to have developed. The deliberate omission of this critical data forces the
11 econometric model to look for “other” causes, such as income and education.

12
13 23. Even so, the model still does not support the linkage that Hausman/Sidak seek to
14 make. The principal statistical test used to assess the overall explanatory power of an
15 econometric model – the “coefficient of determination” – in this case indicates that the model
16 “explains” only 1.4% of the variation in the average price of long distance calling. Put
17 another way, the author's study actually confirms that *more than 98.6%* of the variation in the
18 price paid by customers is due to factors *other than income and education – factors that are*
19 *not even included in the model itself, such as calling volume!* And because the single most
20 important source of variation – calling volume – has been omitted from the study altogether,
21 even the by-a-thread 1.4% linkage that the authors seek to portray as between price and
22 income/education cannot withstand scrutiny. Stated differently, this near-zero value actually

1 confirms the *lack* of correlation between income/education and price – precisely the opposite
2 of what Hausman/Sidak claim their analysis demonstrates.

3

4 24. Hausman/Sidak cite as the data source for their regression model the “bill
5 harvesting” data collected by TNS Telecoms. The authors do not provide the actual data set;
6 hence, their model results cannot be reproduced, nor can alternative specifications be
7 examined. The TNS survey is conducted in English, and as such would likely exclude non-
8 English-speaking households, a group that is disproportionately represented in the “low-
9 income, less-educated” population segment that Hausman/Sidak purport to have studied. For
10 no apparent reason, Hausman/Sidak excluded all international usage and usage charges from
11 their dataset. In some cases, however, the “discount calling plan” monthly fee includes a
12 fixed amount for a discount international calling “plan.” Unless Hausman/Sidak also
13 excluded that component of the monthly plan charge, they would overstate the per-minute
14 price of the *domestic* calls that were included. If international calling is disproportionately
15 high among the non-native American poor and less-educated, the exclusion of this usage and
16 the possibly incomplete removal of revenues associated therewith could also explain the
17 *apparent* difference in price that the authors claim to have observed.

18

1 **The existence of volume-based pricing of residential long distance service is a**
2 **consequence of competition, not “discrimination.”**
3

4 25. Rather than indicating *discrimination* as Hausman/Sidak claim, the prevalence of
5 volume-based pricing of residential long distance service actually proves that competition is
6 working to bring prices down. In fact, when adjusted for inflation, the real price of long
7 distance calling has dropped by *more than 80%* since the 1984 break-up of the former Bell
8 System, whereas the inflation-adjusted prices of *monopoly* local phone service has remained
9 largely unchanged over that same period.

10

11 26. The “growing divergence between basic and discount prices for MTS” that the
12 authors seek to portray as “discrimination” actually reflects a combination of three key factors
13 – (1) the succession of FCC-ordered reductions in “access charges” that long distance carriers
14 are required to pay local phone companies, (2) the decreasing costs of switching and
15 transmission, and (3) the growth in competition in the long distance market. The increases in
16 prices for low-volume customers results directly from rising costs for account maintenance
17 activities including billing and customer churn. This “growing divergence” is thus neither
18 surprising nor evidence of “discrimination.”

19

20 **BOC entry into the long distance business cannot “cure” a discrimination “problem”**
21 **that does not even exist.**
22

23 27. Contrary to the authors’ portrayal, the Hausman/Sidak “econometric model” actually
24 confirms the *absence of correlation* between the average price per minute and the

1 “explanatory” variables of income, age and education. And by excluding from their “model”
2 the single most important source of long distance price variation - calling volume — whatever
3 “relationship” their model purports to demonstrate as between price and age/income/education
4 is nothing other than spurious. Finally, and by the authors’ own concession, their “third-
5 degree discrimination” theory *requires* that the marginal cost of serving all customers be
6 *identical*, which is demonstrably not the case with residential long distance service. Nothing
7 in the Hausman/Sidak analysis demonstrates that IXCs “discriminate” against the poor and
8 less-educated and, if anything, the utter lack of correlation that the model does affirmatively
9 reveal actually confirms the fact that they do not.

10

11 28. Having advanced this spurious and specious theory, Hausman/Sidak then go on to
12 argue that this “problem” would somehow be “solved” if only the BOCs were allowed to
13 enter the in-region interLATA long distance market. What the authors conveniently ignore,
14 but what I have demonstrated here, is that the BOCs themselves engage in the very same type
15 of volume-based pricing and, in fact, are offering an array of pricing plans that is
16 extraordinarily complex.

17

18 29. Hausman/Sidak claim to have “rerun” their same regression model but this time with
19 the inclusion of 150 households that switched to the BOC for long distance in New York and
20 Texas, and claim that such customers’ prices were lower than for customers remaining with
21 the IXC. No regression statistics were provided with respect to this “rerun” model. It is
22 important to note, at the outset, that the TNS survey does not track the *same* households from

1 one period to the next; hence, it is not possible to the authors to have “calculated the savings
2 to consumers from *switching* to BOC provision of MTS.”¹² Moreover, the authors once
3 again omitted entirely any variable for a customer’s calling volume, the single most important
4 determinant of the average price per minute that the customer pays.¹³

5
6 30. Hausman/Sidak claim that their “rerun” model shows that “BOC customers on
7 average paid ... *less* per minute than customers of all other long-distance providers.” What
8 Hausman/Sidak fail to show is that *these particular customers* had experienced any savings *by*
9 *virtue of having switched to the BOC*. In fact, the results that the authors ascribe to BOC
10 entry is entirely consistent with several other explanations, none of which are even tested for,
11 and are thus not refuted by, the analysis that the authors claim to have performed. Customers
12 switching to or selecting the BOC long distance offering are likely to have been obtaining
13 IXC service under a discount plan before switching to the BOC; hence, even if BOC and IXC
14 prices are the same, this selection of discount plan customers would make the *average* BOC
15 price per minute appear to be lower, but only because the universe of BOC customers was
16 different to begin with.¹⁴

17 12. Hausman/Sidak at 21, emphasis supplied.

18 13. The authors do claim to have “control[ed] for demographic characteristics that could
19 influence the per-minute price of long-distance service.” Of course, inasmuch as the base
20 model does not prove that “demographic characteristics [do] influence the per-minute price of
21 long-distance service,” “controlling” for them serves no valid purpose.

22 14. This possibility is supported by the authors’ finding that “the Chow test ... shows that
23 the way in which demographic characteristics influence the per-minute price of direct-dial

24 (continued...)

1 31. BOC prices are lower for the very low-use customer because both Verizon and SBC
2 offer basic discount plans that do not include a monthly charge or minimum usage level. The
3 BOC long distance affiliates' ability to offer this type of plan stems directly from their unique
4 access to the BOC ILECs' customer service and billing and collection resources. While the
5 BOC ILEC "charges" the BOC long distance affiliate for these services (as it is required to
6 do in accordance with Section 272(b)(5)), the incremental cost *to the overall BOC corporate*
7 *family* of "piggy-backing" these services for the affiliate onto the existing local service
8 business office, billing and collection infrastructure is extremely small. Competing IXCs that
9 do not possess such a near-universal local customer base must provide these functions and
10 incur their costs on a stand-alone basis. Section 272(b)(5) of the federal *Telecommunications*
11 *Act of 1996* requires that the BOC ILEC deal "at arm's length" with their long distance
12 affiliate. If the BOCs were adhering to this statutory requirement — which they are clearly
13 not — the long distance affiliate would not have the ability to absorb the up-front account-
14 sensitive costs. To the extent that the BOC long distance affiliates are willing to forego
15 recovery of these costs through long distance prices and allow their local service operations to
16 cross-subsidize the long distance business in this manner, their ability to charge lower prices

17 14. (...continued)
18 interLATA MTS differs significantly between BOCs and the IXCs." If customers selecting
19 BOC long distance service exhibited similar demographic characteristics to those of IXC
20 customers, one might well conclude that BOC prices were uniformly lower. However, what
21 the Hausman/Sidak findings confirm is that the propensity for a customer to select a BOC
22 was not randomly distributed across the entire sample. If the customers switching to the
23 BOC (or selecting the BOC as their long distance PIC when ordering new local service from
24 the BOC) were already subscribing for an IXC discount calling plan, then the "average-to-
25 average" conclusion that BOC prices are lower would be incorrect, and the asserted "benefit"
26 of BOC entry would be entirely illusory.

1 is far more a demonstration of anticompetitive conduct that it is of conferring economic
2 benefit upon consumers.

3

4 32. In any event, even if the IXCs' pricing practices did work to create the type of
5 "discrimination" that Hausman/Sidak claim - which they do not — there is nothing in the
6 Hausman/Sidak "study" that offers any basis to conclude that BOC entry would do anything
7 to eliminate that alleged discrimination.

8

9 **The succession of price decreases of residential long distance service are in sense the**
10 **result of or caused be BOC entry into the long distance business.**

11

12 33. The dramatic drop in long distance prices that has occurred over the past two
13 decades provides compelling evidence of the extraordinary success of several key FCC
14 policies — the development of competition in telecommunications markets, and the
15 rebalancing of rates to be more reflective of the structure of costs.

16

17 34. The *single most important source* of the enormous drop in long distance prices is the
18 succession of FCC-required decreases in "access charges," the fees that long distance
19 companies pay to local phone companies to connect their long distance networks to the phone
20 companies' local subscribers. Access charges have been dropping steadily following their
21 introduction in 1984, shortly after the break-up of the former Bell System.¹⁵ That, along

22 15. See generally MTS and WATS Market Structure, CC Docket No. 78-72, *Notice of*
23 *Inquiry and Proposed Rulemaking*, 67 FCC 2nd 757 (1978). *Supplemental Order (Phase I)*,
24 (continued...)

1 with unprecedented technological innovation in telephone switching and long-haul
2 transmission technologies and the growth of an intensely competitive long distance market,
3 has pushed down the *real* (inflation-adjusted) price of long distance service by *nearly 80%*
4 since 1983 — the last year before the 1984 Bell System break-up and the introduction of
5 access charges — *without BOC entry into the long distance business*. By contrast, the
6 inflation-adjusted prices of *monopoly* local phone service have remained largely unchanged
7 over that same period (see Figure 2).

8

9 35. In yet another unpublished “study” released at about the same time as their
10 “discrimination” paper, Hausman, Sidak and Gregory K. Leonard claim to have made
11 “empirical findings that BOC entry has produced substantial consumer-welfare benefits in
12 New York and Texas in the form of lower prices for long-distance service” and claim to have
13 found “statistically significant evidence that BOC entry enabled the average consumer to reap
14 a 9-percent savings on her monthly interLATA bill in New York and a 23-percent savings in
15 Texas.”¹⁶ Based upon these findings, the authors go on to “predict that, when the BOCs

16 15. (...continued)
17 94 FCC 2nd 852 (1983). *Phase I Order Modified on Reconsideration*, 97 FCC 2nd 682
18 (1983). *Phase I Order Modified on Further Reconsideration*, 97 FCC 2nd 834 (1984). Phase I
19 Orders Affirmed in Part, *Remanded in Party sub nom. National Association of Regulatory*
20 *Utility Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984). *Cert. denied*, 469 U.S. 1227
21 (1985). *Report and Order (Phase III)*, 100 FCC 2nd 860 (1985). *Phase I Order Modified on*
22 *Second Further Reconsideration*, 101 FCC 2nd 1222 (1985). *Aff'd sub nom. American*
23 *Telephone & Telegraph Co. v. FCC*, 832 F.2d 1285 (D.C. Cir. 1987).

24 16. Jerry A. Hausman, Gregory K. Leonard and J. Gregory Sidak, “The Consumer-Welfare
25 Benefits from Bell Company Entry into Long-Distance Telecommunications: Empirical
26 (continued...) ”

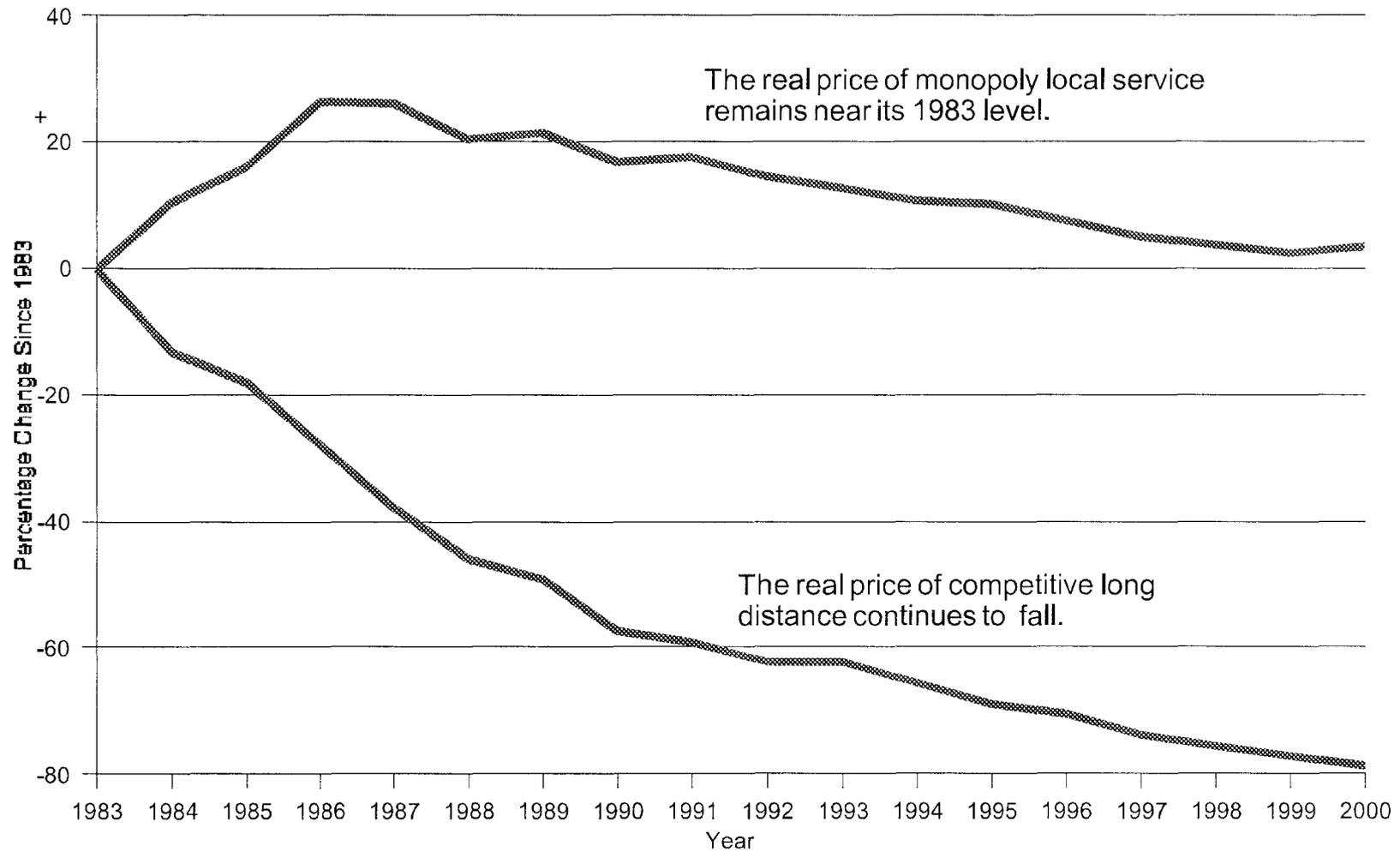


Figure 2: Adjusted for inflation, long distance rates have fallen by nearly 80% since 1983, the last year before the Bell System break-up. By contrast, ILEC local rates have remained essentially unchanged over that same period.

Source: FCC, *Trends in Telephone Service*, Table 14.5; FCC, *Statistics of Communication Common Carriers*, 1995/1996 Edition, Table 8.4 and 2001 Edition, Table 5.6; Bureau of Labor Statistics, Inflation Calculator at: <http://www.bls.gov/cpi/>. Long distance rate for 2000 is an estimate.



1 receive section 271 approvals in other states, a similar significant decrease in long-distance
2 prices will occur that leads to consumer benefits.” As with their other “study,”
3 Hausman/Leonard/Sidak (“HLS”) once again fail to provide the actual data set that they
4 utilized in their regression analysis; hence, once again their model results cannot be
5 reproduced, nor can alternative specifications be examined. Significantly, whereas in the
6 “discrimination” paper the authors did cite TNS Telecoms as the source of the billing data
7 that they used, in their “Consumer-Welfare Benefits” paper *no source for the data is provided*
8 *at all* for the “empirical evidence” upon which their “conclusion” is founded! Additionally,
9 the authors inexplicably “eliminated households with more than one telephone line and
10 households that switched service providers during the billing cycle” but provide no
11 justification or rationale for deliberately selecting-out such customers.¹⁷ Customers who

12 16. (...continued)
13 Evidence from New York and Texas,” available at
14 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=289851

15 17. Hausman/Leonard/Sidak eliminated households with more than one long distance bill
16 during a billing period, apparently *assuming* that this will “eliminate households with more
17 than one telephone line and households that switched service providers during the billing
18 cycle.” Hausman/Leonard/Sidak, at 6. This statement is not true, since (a) multiple-line
19 households can in fact have a single long distance bill — either because the second line has
20 no PIC at all, or because the IXC combines calls for the several working telephone numbers
21 on a single bill. Also, there are many explanations for why a customer would have more than
22 one bill. For example, a customer would receive “multiple” long distance bills if he places
23 some but less than all calls on a 1+ basis using the PIC’ed carrier, and uses one or more “dial
24 around” (“101-XXXX”) services for the remaining calls. Even where both the PIC’ed IXC
25 and the 101-XXXX usage is billed through the local phone company, TNS will nonetheless
26 identify the customer as having received two “separate” long distance bills. Thus, if the
27 customer uses AT&T (for example) as the PIC but also uses 1010-220 (Telecom USA), the
28 TNS customer record will show two separate bills, and thus would have been omitted from
29 (continued...)

1 switch carriers or who have two phone lines are likely to be above-average users who are also
2 more aware of the various pricing options, and are thus most likely to have been paying lower
3 rates to begin with; thus, eliminating these customers likely creates a systematic upward bias
4 in the resulting average prices.

5

6 36. The "methodology" utilized by HLS involved the development of comparisons
7 between the first two states in which BOCs had received Section 271 authority (New York
8 and Texas) with two "control" states — Pennsylvania for New York, and California for Texas
9 — that they selected. The authors' claims of "9-percent savings ... in New York and a 23-
10 percent savings in Texas" were developed on the basis of comparing New York vs. Pennsyl-
11 vania and Texas vs. California average bill changes between the second half of 1999
12 ("2H99") and the second half of 2000 ("2H00"). In making these comparisons, HLS used the
13 New York 2H00 usage characteristics to develop the average bill for both time periods *and*
14 *for both states* (New York and Pennsylvania); similarly, the 2H00 Texas usage characteristics
15 was used to develop the average bill for both time periods and for both Texas and California.

16 17. (...continued)
17 the Hausman/Sidak dataset. In addition, characteristics of customers with a "single bill" may
18 differ from state to state, rendering incorrect the comparisons of these unique sub-groups
19 across several states. It is also unclear as to how Hausman/Sidak treated so-called "threshold
20 billed" customers, low-volume users who do not receive a long distance bill every month, but
21 are billed once every 2-3 months or when their accumulated bill reaches a "threshold" level,
22 e.g., \$30, whichever comes first. Depending upon whether a particular customer happened to
23 be billed in a particular month, some of these customers will have no long distance bill in the
24 TNS data, while others will have a bill that reflects several months' usage. Hausman/Sidak
25 may have excluded these customers altogether as not meeting the criteria of "... having only a
26 single long distance bill during the billing cycle," or they could have misinterpreted the total
27 threshold billing level as representative of the customer's usage *in the billing month*.

1 While there might be some justification for holding usage constant *within the same state* for
2 the two different time periods so as to accurately measure the effects of price changes *in each*
3 *jurisdiction*,¹⁸ the use of New York and Texas usage for Pennsylvania and California,
4 respectively, serves only to distort local usage patterns, which are heavily influenced by such
5 state-specific attributes as geography, number of LATAs, and the relationship between
6 customers' communities of interest and their local calling areas.

7
8 37. Although HLS do not disclose where they obtained their "empirical data," the TNS
9 Telecoms "bill harvesting" survey (the source that Hausman/Sidak had used for their
10 "discrimination" study) is also a source of the type of data that could be used to draw
11 comparisons between "Section 271 states" and those in which BOC long distance entry is still
12 barred. AT&T subscribes to the TNS Telecoms data, and at my request prepared summary
13 results in the same format and for the same two time periods as those selected by HLS for the
14 four states whose results are provided by HLS as well as for several other non-271 states in
15 which the average long distance bill decreased by *considerably more* than in either New York
16 or Texas. These results are reproduced in Tables 3 and 4 below. For the sake of comparison

17 18. Even so, using 2H00 minutes for both 1999 and 2000 may produce distorted results, if
18 the price changes occurring between the two time periods are such as to affect consumer
19 behavior either in terms of total consumption or the mix of peak and off-peak calling. New
20 calling plans that either eliminate peak/off-peak price distinctions or that modify the peak/off-
21 peak price relationships, or the introduction of "block-of-time" plans, could materially impact
22 calling volumes. For example, under a block-of-time plan (e.g., SBC's 300 minutes for \$18
23 offering), a customer who might ordinarily use only 200 minutes would view the additional
24 100 minutes as "free," and might well increase total usage considerably to the extent that such
25 an increase does not result in a higher total bill. Holding calling volumes constant over the
26 two time periods used in the HLS "analysis" ignores this important effect.

1 (and because we were not able to replicate the precise HLS summary data either because they
2 had obtained it from a source other than TNS Telecoms and/or because they may have
3 processed the individual billing data differently¹⁹), I also requested that AT&T provide
4 results for the four states used by HLS using the same methodology as was used for the four
5 additional states, except that for each state, I asked that that state's usage characteristics be
6 utilized instead of the New York and Texas usage levels that HLS had incorrectly used for
7 their "control" state calculations.

8

9 38. When the results for the two HLS "control states" (Pennsylvania and California) are
10 recalculated using the usage characteristics *of those states* rather than those of New York for
11 Pennsylvania and Texas for California, the price decreases in the two HLS "control states"
12 turn out to have been significantly larger than those reported by the authors — a 10.52%
13 decrease for Pennsylvania rather than the 1.89% calculated by HLS based upon *New York*
14 usage characteristics, and an 11.93% decrease for California rather than the 0.77% *increase*
15 that HLS had calculated using *Texas* usage levels:

19. The TNS Telecoms Bill Harvesting data contains virtually all information from customer bills along with both "state weights" and "national weights." Due to the literally hundreds of carriers, types of calling plans, etc., the resulting database is extremely complex. The user of the data must make many decisions about what records to include or exclude, the appropriate weights to use, etc. Because it is unclear whether in fact the TNS data was the data source and, in any event, none of the details as to how the data was processed and utilized are documented in the Hausman/Sidak paper, there is no way to determine whether the data was used correctly and consistently.

Table 3						
Savings on InterLata Bills for the Average Customer New York and Pennsylvania						
	Avg Mins (NY 2H00)	Avg Price NY 2H99	Avg Price NY 2H00	Avg Mins PA 2H00	Avg Price PA 2H99	Avg Price PA 2H00
Peak (7am - 7pm weekdays)	32	\$0.17	\$0.13	23	\$0.17	\$0.14
Off Peak (7pm - 7am weekdays & Sat.)	48	\$0.12	\$0.09	28	\$0.14	\$0.11
Off Peak (Sunday)	20	\$0.09	\$0.08	13	\$0.09	\$0.09
Fee (MRC)		\$1.17	\$1.66		\$1.19	\$1.61
Total Bill *		\$14.19	\$11.80		\$10.10	\$9.14
Total Savings			\$2.39			\$0.96
Savings as Percentage of Total Bill			20.26%			10.52%
Incremental Savings in Entry State			\$1.43			
Incremental Savings as Percentage of Total Bill			9.74%			
Texas and California						
	Avg Mins TX 2H00	Avg Price TX 2H99	Avg Price TX 2H00	Ave Mins CA 2H00	Avg Price CA 2H99	Avg Price CA 2H00
Peak (7am - 7pm weekdays)	31	\$0.15	\$0.12	38	\$0.15	\$0.12
Off Peak (7pm - 7am weekdays & Sat.)	42	\$0.13	\$0.11	34	\$0.12	\$0.10
Off Peak (Sunday)	16	\$0.10	\$0.09	21	\$0.09	\$0.08
Fee (MRC)		\$1.85	\$1.68		\$1.43	\$1.87
Total Bill *		\$13.64	\$11.56		\$12.94	\$11.56
Total Savings			\$2.08			\$1.38
Savings as Percentage of Total Bill			17.96%			11.93%
Incremental Savings in Entry State			\$0.70			
Incremental Savings as Percentage of Total Bill			6.03%			

Notes to Tables 3 and 4: To attempt to match HLS methodology, only households with one Long Distance Bill were included in the sample. Threshold billed households (i.e., consumers billed only once every "x" months or when a certain spending level is reached) were also excluded. Average Minutes and Price was calculated for interLATA domestic dial-1 calls only; international calls were excluded. Minutes without associated charges (i.e., such as calls made with "block-of-time" plans) were included in average price per minute calculations since the corresponding charges are reflected in the monthly recurring charges (MRC). Source: TNS Telecoms ReQuest Bill Harvesting Study, National Weight used. (TNS advises use of national weights when two or more states are being compared.)

1 39. The specific choice of "control states" and the two time periods was entirely
2 arbitrary. Because we do not know exactly what data sources were used or whether alternate
3 "control states" or alternate time periods were examined, there is no basis to conclude that the
4 particular *entirely non-random* selections of Pennsylvania and California that were made by
5 HLS are in any way representative of actual conditions. During the 2H99 through 2H00 time
6 frame, of the 48 jurisdictions (47 states plus the District of Columbia) in which Bell operating
7 companies provide local telephone service, 46 had not as of that time frame received Section
8 271 authority. Thus, HLS had a wide range of choices for their "control states." Had they
9 selected different "control" states, their "comparisons" might well have yielded dramatically
10 different results. For example, if Florida, Wisconsin, Missouri or Kentucky were used instead
11 of Pennsylvania and California as the "control states" for New York and Texas, then rather
12 than indicating "consumer-welfare benefits" of BOC entry, one would instead conclude
13 *precisely the opposite* — that BOC entry had *harmed* consumers — since the price decreases
14 in these *non-271 states* was significantly greater than for either New York or Texas.

Table 4						
Savings on InterLATA Bills for the Average Customer in Alternate "Control" States						
Kentucky and Florida						
	Avg Mins KY 2H00	Avg Price KY 2H99	Avg Price KY 2H00	Avg Mins FL 2H00	Avg Price FL 2H99	Avg Price FL 2H00
Peak (7am-7pm wkdys)	41	\$0.22	\$0.10	46	\$0.20	\$0.11
Off Peak (7pm-7am weekdays & Sat.)	39	\$0.17	\$0.07	59	\$0.14	\$0.09
Off Peak (Sunday)	17	\$0.14	\$0.06	29	\$0.12	\$0.08
Fee (MRC)		\$1.06	\$3.43		\$0.99	\$2.10
Total Bill		\$19.33	\$11.24		\$21.76	\$14.92
Total Savings			\$8.09			\$6.84
Savings as Pct of Total			72.03%			45.88%
NY Savings (\$)			\$2.39			\$2.39
NY Savings (%)			20.26%			20.26%
TX Savings (\$)			\$2.08			\$2.08
TX Savings (%)			17.96%			17.96%
Missouri and Wisconsin						
	Avg Mins MO 2H00	Avg Price MO 2H99	Avg Price MO 2H00	Avg Mins WI 2H00	Avg Price WI 2H99	Avg Price WI 2H00
Peak (7am-7pm wkdys)	24	\$0.23	\$0.10	46	\$0.23	\$0.10
Off Peak (7pm-7am weekdays & Sat.)	30	\$0.16	\$0.08	75	\$0.16	\$0.08
Off Peak (Sunday)	13	\$0.11	\$0.10	25	\$0.11	\$0.10
Fee (MRC)		\$2.14	\$2.59		\$2.02	\$2.75
Total Bill		\$14.12	\$8.92		\$27.71	\$16.33
Total Savings			\$5.19			\$11.39
Savings as Pct of Total			58.19%			69.73%
NY Savings (\$)			\$2.39			\$2.39
NY Savings (%)			20.26%			20.26%
TX Savings (\$)			\$2.08			\$2.08
TX Savings (%)			17.96%			17.96%

1 40. From my inspection of the TNS bill harvesting data for all states that was provided
2 to me by AT&T, it is clear that there is *enormous variation* from state-to-state in the
3 percentage and absolute dollar change in average rate per minute between the 2H99 and 2H00
4 rate periods. There are a number of reasons why this variation is present, reasons that have
5 nothing to do with BOC entry or lack thereof. One particularly important source of
6 difference results from the *timing* of access charge reductions in each state. For example,
7 California intrastate access charges were subject to substantial decreases as a result of two
8 CPUC rate rebalancing decisions that took effect in 1995 and 1998, respectively.²⁰ The
9 corresponding decrease in Texas access charges did not occur until the 1999-2000 time frame,
10 following an act of the Texas legislature requiring the reductions and flow-through in retail
11 intrastate long distance rates.²¹ There is also considerable variation in access charge rate
12 level, and hence retail toll rate levels, from state to state. For example, according to HLS'
13 Table 4, peak period rates in Texas decreased from 19.3 cents to 14.4 cents between 2H99
14 and 2H00. But that same table also indicates that peak rates in California *started out* in 2H99

15 20. California PUC, I.87-11-033, *Alternative Regulatory Frameworks for Local Exchange*
16 *Carriers*, Implementation and Rate Design phase, Decision (D.)94-09-065, 56 CPUC 2d 117
17 (1994); *Re: Pacific Bell*, A.97-03-004, D.98.07-033, 187 PUR 4th 120 (1998).

18 21. Texas Sen. Bill 560 (1999). On August 9, 1999, the Texas PUC voted (in Dockets
19 18515 and 18516) to reduce intrastate access charges for all ILECs by a weighted average of
20 approximately \$0.05 per minute (both ends). For the first nine months of 1999, the combined
21 Southwestern Bell originating and terminating switched access rate was 11.89 cents.
22 Following several reductions, by July of 2000, the beginning of the "post-entry" 2H00 period
23 presented in the HLS study, those rates had dropped to 5.66 cents. Verizon's rates over that
24 same period went from 12.72 cents down to 3.25 cents. Excerpts from the Texas PUC's
25 report to the Texas legislature regarding these access rate reductions is provided as
26 Attachment 3 to this Declaration.

1 at only 14.9 cents, dropping to 13.7 cents a year later. Obviously, Texas had much further to
2 go than California, so it's hardly surprising that the percentage and dollar reductions were
3 greater. Yet another factor influencing the average interLATA rate is the relative mix of
4 intraLATA vs. interLATA and intrastate vs. interstate calling. The size of the local calling
5 areas, and the number and geography of LATAs is also a key factor. New York has much
6 larger local calling areas than Pennsylvania, whereas calling to northern New Jersey, which
7 represents a substantial portion of the New York City metropolitan area, is interstate
8 interLATA. Texas has large flat-rate local calling areas covering, in each case, entire
9 metropolitan areas. By contrast, California, whose metropolitan areas are far more expansive
10 than those in Texas, limits flat-rate local calling to a 12-mile band. All of these factors have
11 a material impact upon price level and the nature of price changes, *yet HLS did not control*
12 *for even a single one of them in their "model."*

13

14 41. As I have previously noted, while the reductions in access charges at both the
15 interstate and intrastate levels have been and continue to be the largest single factor in driving
16 down long distance prices, there is no "access charge" explanatory variable in the HLS
17 model. As with their "discrimination" claim, the omission of this critically important variable
18 renders all other model results entirely spurious. Indeed, whereas in the "discrimination"
19 model the authors admit to an R^2 of 1.4%, in their "consumer-welfare benefits" model they do
20 not even disclose the R^2 at all, suggesting that it is probably even lower than 1.4%!

21

1 42. For example, the roughly 3-cent drop in the average price of long distance calling in
2 Texas between 1999 and 2000 that HLS report and that they seek to ascribe to SBC's entry
3 into the long distance market is *entirely attributable* to an average decrease of slightly *more*
4 than 3 cents in intrastate and interstate access charges that occurred in Texas in that same
5 time frame.²²

6
7 43. HLS's choice of time periods — which ended as of the second half of 2000 — is
8 particularly noteworthy in light of the fact that, in February 2001 — *immediately following the*
9 *end of the HLS "study period"* — SBC increased its Texas long distance rates by between 1
10 and 2 cents a minute — erasing nearly half of the access charge driven rate decreases that had
11 occurred in the previous year.²³ By limiting their "study" to 1999 and 2000, HLS conven-

12 22. SWBT's access charges decreased by approximately \$0.035 per minute; Verizon
13 (GTE) by about \$0.096 (terminating by \$0.067). From 2H99 to 2H00, interstate switched
14 access charges dropped by about \$0.01, for a weighted average decrease (for intrastate calls
15 originated on SWBT phones) of approximately \$0.031 per minute. HIS identify average
16 savings per Texas customer at \$3.04 with average usage of 97 minutes, representing an
17 average price decrease per minute of \$0.0313, *almost exactly the same as the decrease in*
18 *access charges*. Hence, essentially *all* of the price decrease that authors ascribe to "BOC
19 entry" in Texas is entirely attributable to reduced access charges, *which the authors chose to*
20 *exclude from their model and causality analysis*. With respect to the "control" state for Texas
21 — California — the authors identify virtually no price change for California between 2H99
22 and 2H00 (the total LD bill is shown as decreases by \$0.098 for the same 97 minutes of
23 usage, or about \$0.001 per minute. California *intrastate* access charges were reduced in 1995
24 and again in 1998, but during the 2H99-2H00 period remained essentially unchanged, and
25 *interstate* access charges decreases by about \$0.01, for a weighted average decrease of around
26 \$0.004.

27 23. "SW Bell raises interstate rate; current subscribers unaffected; PUC approval not
28 needed," *Ft. Worth Star-Telegram*, February 2, 2001:

29

(continued...)

1 iently *leave out* that large rate increase that SBC had put through following its long distance
2 entry. The HLS study also conveniently omits any mention of the increases in *local* rates that
3 occurred in Texas since SBC started selling long distance service. For example, Southwestern
4 Bell increased monthly rates for popular features like Caller ID from \$4.95 to \$7.00 between
5 January 1, 2000 and January 1, 2002.²⁴ During that same period, SBC's Texas rates for Call
6 Forwarding and Three-way Calling went from \$2.10 each to \$5.00 each, and SBC increased
7 its local directory assistance rate from \$0.30 to \$1.25.²⁵

8

9 23. (...continued)

10

11 Southwestern Bell announced it was raising the interstate rate on its flagship plan from 9
12 cents a minute to 10 cents a minute for new customers seven months after entering the
13 long-distance market in Texas. Current subscribers will see no change in their domestic
14 U.S. calling charges, said Shawn Ramsey, a San Antonio-based spokeswoman for
15 Southwestern Bell, a unit of SBC Communications.

16

17 Ramsey defended the increase, which doesn't require approval by the state's Public
18 Utility Commission, by saying the plan is superior to many offered by the major long-
19 distance services. "We beat the pants off of them," she said. "We've got great rates any
20 way you slice or dice it." Asked if the higher rate reflects a need to boost profits, she
21 said: "We've been in the market about eight months now. We've learned a lot and made
22 a number of changes that reflect what we've seen. And we've changed our plan
23 accordingly."

24 24. SWBT-Texas General Exchange Tariff, Sec. 10, Sheet 9, Revision 3, Eff. August 26,
25 1998; Revision 7, Eff. January 17, 2002.

26 25. *Id.*

1 **Conclusion**

2

3 44. HLS provide no credible support for the purported “consumer-welfare benefits” they
4 seek to ascribe to BOC entry into the in-region interLATA long distance market in New York
5 and Texas. The “econometric model” omitted access charges — the single most important
6 explanatory variable affecting the price of long distance service — as well as other potential
7 sources of differences in individual state pricing and usage attributes. Their selection of
8 “control states” against which to “compare” outcomes for New York and Texas was arbitrary
9 and entirely results-driven, inasmuch as decidedly opposite conclusions regarding consumer-
10 welfare benefits would have been obtain had HLS selected Florida, Wisconsin, Missouri or
11 Kentucky — or possibly others — as their “control states.” Calculations of rate changes for
12 the “control states” that were selected by the authors — Pennsylvania and California —
13 incorrectly utilized New York and Texas usage characteristics rather than usage attributes for
14 the “control states” themselves. No sources were provided for the data upon which the HSL
15 “model” was based, and customers with more than one telephone line or who changed long
16 distance companies during the billing month used for the sample were inexplicably — and
17 improperly — eliminated from the sample data. It is not clear whether the HLS dataset
18 includes or excludes international usage, nor is there any indication as to how the monthly fee
19 was handled if the particular calling plan to which the customer subscribed also included
20 discounted international calling.

21

22 45. There is simply no valid scientific basis for HLS’s attempt to ascribe the lower long
23 distance rates that existed in 2000 vs. 1999 to BOC long distance entry, and their convoluted

1 effort to advance such a theory is devoid of credibility and fails entirely to demonstrate that
2 BOC entry into the in-region long distance market is in the public interest.

3

4 The foregoing statements are true and correct to the best of my knowledge, information
5 and belief.

6

7

8

9



LEE L. SELWYN

Attachment 1:
Statement of Qualifications

DR. LEE L. SELWYN

Dr. Lee L. Selwyn has been actively involved in the telecommunications field for more than twenty-five years, and is an internationally recognized authority on telecommunications regulation, economics and public policy. Dr. Selwyn founded the firm of Economics and Technology, Inc. in 1972, and has served as its President since that date. He received his Ph.D. degree from the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. He also holds a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with honors in Economics from Queens College of the City University of New York.

Dr. Selwyn has testified as an expert on rate design, service cost analysis, form of regulation, and other telecommunications policy issues in telecommunications regulatory proceedings before some forty state commissions, the Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission, among others. He has appeared as a witness on behalf of commercial organizations, non-profit institutions, as well as local, state and federal government authorities responsible for telecommunications regulation and consumer advocacy.

He has served or is now serving as a consultant to numerous state utilities commissions including those in Arizona, Minnesota, Kansas, Kentucky, the District of Columbia, Connecticut, California, Delaware, Maine, Massachusetts, New Hampshire, Vermont, New Mexico, Wisconsin and Washington State, the Office of Telecommunications Policy (Executive Office of the President), the National Telecommunications and Information Administration, the Federal Communications Commission, the Canadian Radio-television and Telecommunications Commission, the United Kingdom Office of Telecommunications, and the Secretaria de Comunicaciones y Transportes of the Republic of Mexico. He has also served as an advisor on telecommunications regulatory matters to the International Communications Association and the Ad Hoc Telecommunications Users Committee, as well as to a number of major corporate telecommunications users, information services providers, paging and cellular carriers, and specialized access services carriers.

Dr. Selwyn has presented testimony as an invited witness before the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance and before the U.S. Senate Judiciary Committee, on subjects dealing with restructuring and deregulation of portions of the telecommunications industry.

In 1970, he was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time sharing industry. This work was conducted at Harvard University's Program on Technology and Society,

Dr. Lee L. Selwyn (continued)

where he was appointed as a Research Associate. Dr. Selwyn was also a member of the faculty at the College of Business Administration at Boston University from 1968 until 1973, where he taught courses in economics, finance and management information systems.

Dr. Selwyn has published numerous papers and articles in professional and trade journals on the subject of telecommunications service regulation, cost methodology, rate design and pricing policy. These have included:

“Taxes, Corporate Financial Policy and Return to Investors”
National Tax Journal, Vol. XX, No.4, December 1967.

“Pricing Telephone Terminal Equipment Under Competition”
Public Utilities Fortnightly, December 8, 1977.

“Deregulation, Competition, and Regulatory Responsibility in the Telecommunications Industry”
Presented at the 1979 Rate Symposium on Problems of Regulated Industries - Sponsored by: The American University, Foster Associates, Inc., Missouri Public Service Commission, University of Missouri-Columbia, Kansas City, MO, February 11 - 14, 1979.

“Sifting Out the Economic Costs of Terminal Equipment Services”
Telephone Engineer and Management, October 15, 1979.

“Usage-Sensitive Pricing” (with G. F. Borton)
(a three part series)
Telephony, January 7, 28, February 11, 1980.

“Perspectives on Usage-Sensitive Pricing”
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“Diversification, Deregulation, and Increased Uncertainty in the Public Utility Industries”
Comments Presented at the Thirteenth Annual Conference of the Institute of Public Utilities, Williamsburg, VA - December 14 - 16, 1981.

“Local Telephone Pricing: Is There a Better Way?; The Costs of LMS Exceed its Benefits: a Report on Recent U.S. Experience.”
Proceedings of a conference held at Montreal, Quebec - Sponsored by Canadian Radio-Television and Telecommunications Commission and The Centre for the Study of Regulated Industries, McGill University, May 2 - 4, 1984.

Dr. Lee L. Selwyn (continued)

“Long-Run Regulation of AT&T: A Key Element of A Competitive Telecommunications Policy”
Telematics, August 1984.

“Is Equal Access an Adequate Justification for Removing Restrictions on BOC Diversification?”
Presented at the Institute of Public Utilities Eighteenth Annual Conference, Williamsburg, VA - December 8 - 10, 1986.

“Market Power and Competition Under an Equal Access Environment”
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“Contestable Markets: Theory vs. Fact”
Presented at the Conference on Current Issues in Telephone Regulations: Dominance and Cost Allocation in Interexchange Markets - Center for Legal and Regulatory Studies Department of Management Science and Information Systems - Graduate School of Business, University of Texas at Austin, October 5, 1987.

“The Sources and Exercise of Market Power in the Market for Interexchange Telecommunications Services”
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“Assessing Market Power and Competition in The Telecommunications Industry: Toward an Empirical Foundation for Regulatory Reform”
Federal Communications Law Journal, Vol. 40 Num. 2, April 1988.

“A Perspective on Price Caps as a Substitute for Traditional Revenue Requirements Regulation”
Presented at the Twentieth Annual Conference - “New Regulatory Concepts, Issues and Controversies” - Institute of Public Utilities, Michigan State University, Williamsburg, VA, December, 1988.

“The Sustainability of Competition in Light of New Technologies” (with D. N. Townsend and P. D. Kravtin)
Presented at the Twentieth Annual Conference - Institute of Public Utilities Michigan State University, Williamsburg, VA, December, 1988.

Dr. Lee L. Selwyn (continued)

“Adapting Telecom Regulation to Industry Change: Promoting Development Without Compromising Ratepayer Protection” (with S. C. Lundquist)
IEEE Communications Magazine, January, 1989.

“The Role of Cost Based Pricing of Telecommunications Services in the Age of Technology and Competition”
Presented at National Regulatory Research Institute Conference, Seattle, July 20, 1990.

“A Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network” (with Patricia D. Kravtin and Paul S. Keller)
Columbus, Ohio: *National Regulatory Research Institute*, September 1991.

“Telecommunications Regulation and Infrastructure Development: Alternative Models for the Public/Private Partnership”
Prepared for the Economic Symposium of the International Telecommunications Union Europe Telecom '92 Conference, Budapest, Hungary, October 15, 1992.

“Efficient Infrastructure Development and the Local Telephone Company’s Role in Competitive Industry Environment” *Presented at the Twenty-Fourth Annual Conference, Institute of Public Utilities, Graduate School of Business, Michigan State University, “Shifting Boundaries between Regulation and Competition in Telecommunications and Energy”*, Williamsburg, VA, December 1992.

“Measurement of Telecommunications Productivity: Methods, Applications and Limitations” (with Françoise M. Clottes)
Presented at Organisation for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, '93 Conference “Defining Performance Indicators for Competitive Telecommunications Markets”, Paris, France, February 8-9, 1993.

“Telecommunications Investment and Economic Development: Achieving efficiency and balance among competing public policy and stakeholder interests”
Presented at the 105th Annual Convention and Regulatory Symposium, National Association of Regulatory Utility Commissioners, New York, November 18, 1993.

“The Potential for Competition in the Market for Local Telephone Services” (with David N. Townsend and Paul S. Keller)
Presented at the Organization for Economic Cooperation and Development Workshop on Telecommunication Infrastructure Competition, December 6-7, 1993.

Dr. Lee L. Selwyn (continued)

“Market Failure in Open Telecommunications Networks: Defining the new natural monopoly,” *Utilities Policy*, Vol. 4, No. 1, January 1994.

The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, (with Susan M. Gately, et al) a report prepared by ETI and Hatfield Associates, Inc. for AT&T, MCI and CompTel, February 1994.

Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition, (Susan M. Gately, et al) a report prepared by ETI for AT&T, July 1995.

“Efficient Public Investment in Telecommunications Infrastructure”
Land Economics, Vol 71, No.3, August 1995.

Funding Universal Service: Maximizing Penetration and Efficiency in a Competitive Local Service Environment, Lee L. Selwyn with Susan M. Baldwin, under the direction of Donald Shephard, A Time Warner Communications Policy White Paper, September 1995.

Stranded Investment and the New Regulatory Bargain, Lee L. Selwyn with Susan M. Baldwin, under the direction of Donald Shephard, A Time Warner Communications Policy White Paper, September 1995

“Market Failure in Open Telecommunications Networks: Defining the new natural monopoly,” in *Networks, Infrastructure, and the New Task for Regulation*, by Werner Sichel and Donal L. Alexander, eds., University of Michigan Press, 1996.

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The Cost of Universal Service, A Critical Assessment of the Benchmark Cost Model, Susan M. Baldwin with Lee L. Selwyn, a report prepared by Economics and Technology, Inc. on behalf of the National Cable Television Association and submitted with Comments in FCC Docket No. CC-96-45, April 1996.

Economic Considerations in the Evaluation of Alternative Digital Television Proposals, Lee L. Selwyn (as Economic Consultant), paper prepared for the Computer Industry Coalition on Advanced Television Service, filed with comments in FCC MM Docket No. 87-268, In the Matter of Advanced

Dr. Lee L. Selwyn (continued)

Television Systems and Their Impact Upon the Existing Television Broadcast Service, July 11, 1996.

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The Effect of Internet Use On The Nation's Telephone Network, Lee L. Selwyn and Joseph W. Laszlo, a report prepared for the Internet Access Coalition, July 22, 1997.

Regulatory Treatment of ILEC Operations Support Systems Costs, Lee L. Selwyn, Economics and Technology, Inc., September 1997.

The "Connecticut Experience" with Telecommunications Competition: A Case in Getting it Wrong, Lee L. Selwyn, Helen E. Golding and Susan M. Gately, Economics and Technology, Inc., February 1998.

Where Have All The Numbers Gone?: Long-term Area Code Relief Policies and the Need for Short-term Reform, prepared by Economics and Technology, Inc. for the Ad Hoc Telecommunications Users Committee, International Communications Association, March 1998.

Broken Promises: A Review of Bell Atlantic-Pennsylvania's Performance Under Chapter 30, Lee L. Selwyn, Sonia N. Jorge and Patricia D. Kravtin, Economics and Technology, Inc., June 1998.

Building A Broadband America: The Competitive Keys to the Future of the Internet, Lee L. Selwyn, Patricia D. Kravtin and Scott A. Coleman, a report prepared for the Competitive Broadband Coalition, May 1999.

Bringing Broadband to Rural America: Investment and Innovation In the Wake of the Telecom Act, Lee L. Selwyn, Scott C. Lundquist and Scott A. Coleman, a report prepared for the Competitive Broadband Coalition, September 1999.

Dr. Selwyn has been an invited speaker at numerous seminars and conferences on telecommunications regulation and policy, including meetings and workshops sponsored by the National Telecommunications and Information Administration, the National Association of

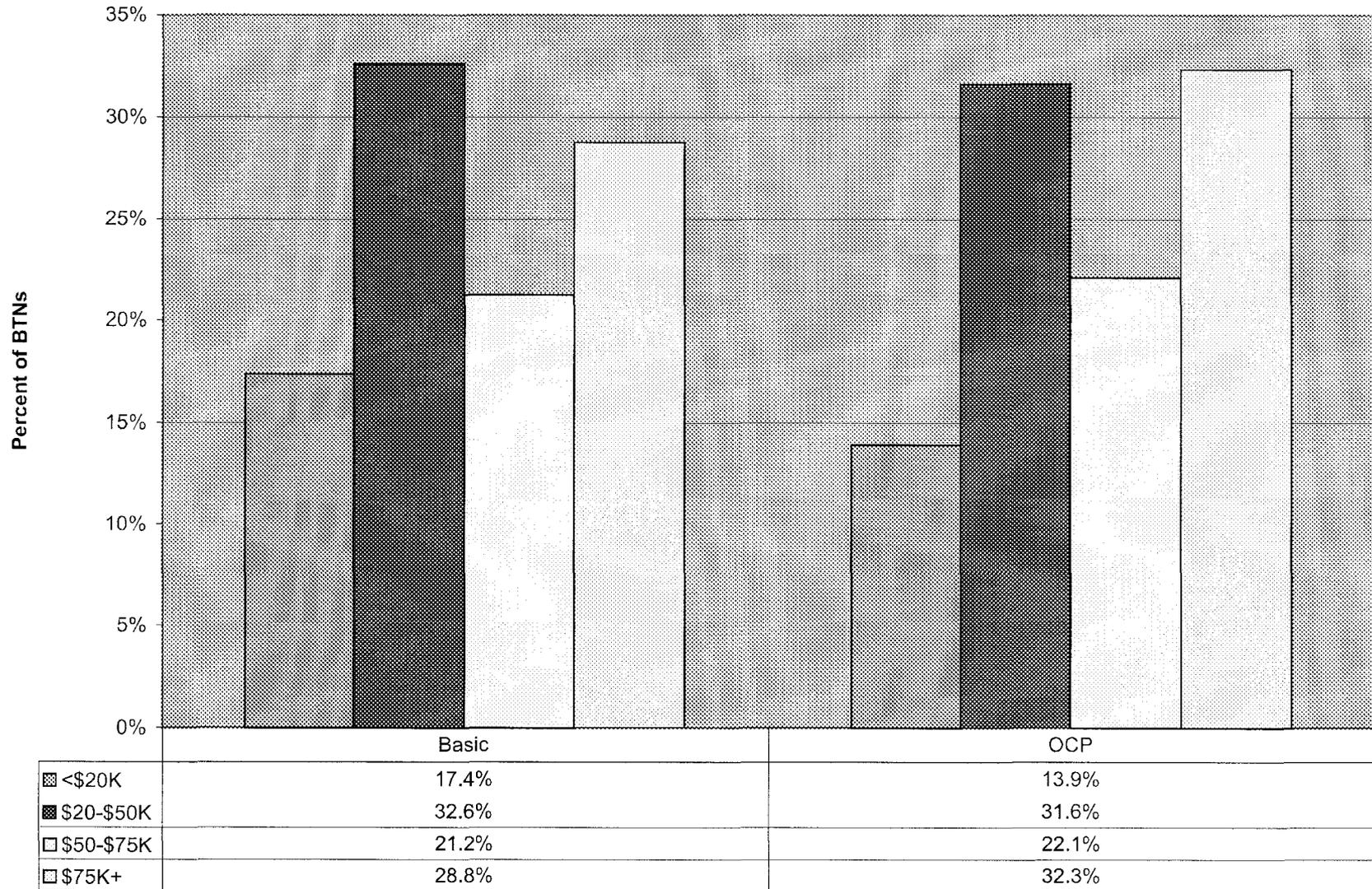
Dr. Lee L. Selwyn (continued)

Regulatory Utility Commissioners, the U.S. General Services Administration, the Institute of Public Utilities at Michigan State University, the National Regulatory Research Institute at Ohio State University, the Harvard University Program on Information Resources Policy, the Columbia University Institute for Tele-Information, the International Communications Association, the Tele-Communications Association, the Western Conference of Public Service Commissioners, at the New England, Mid-America, Southern and Western regional PUC/PSC conferences, as well as at numerous conferences and workshops sponsored by individual regulatory agencies.

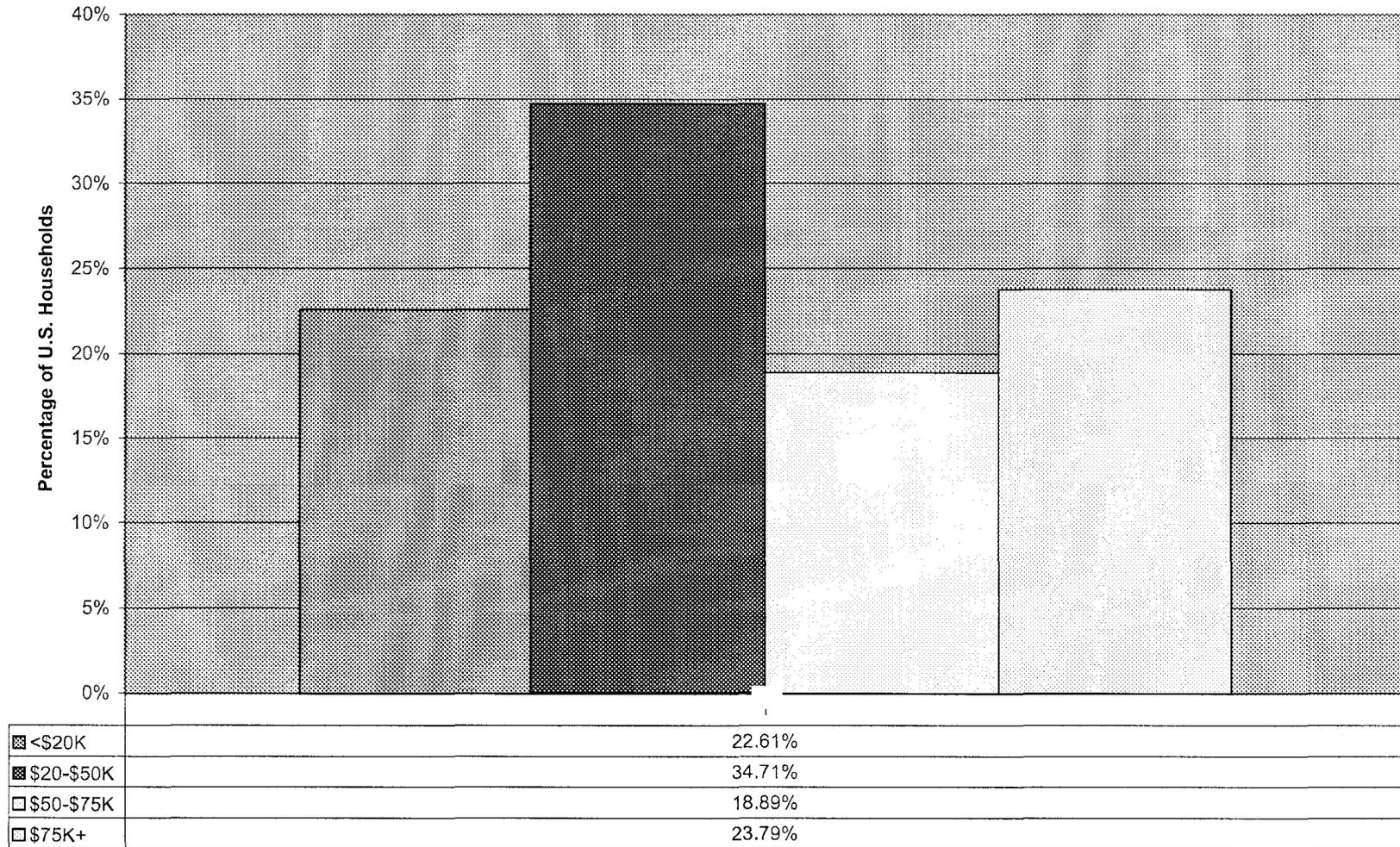
Attachment 2:

**AT&T Customer Demographic Data
Basic and Optional Calling Plans**

Income Distribution by Calling Plan

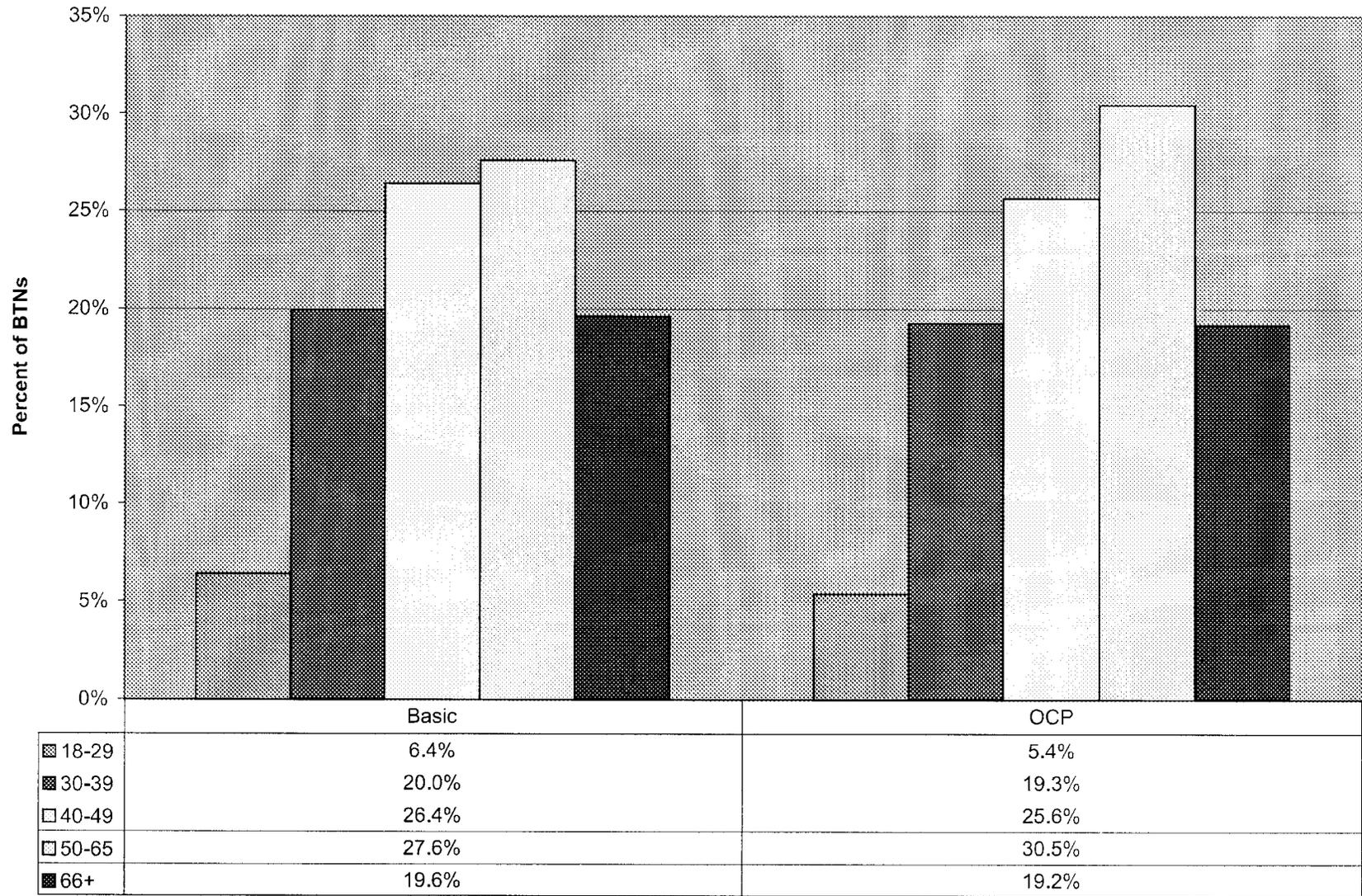


US Household Distribution by Income

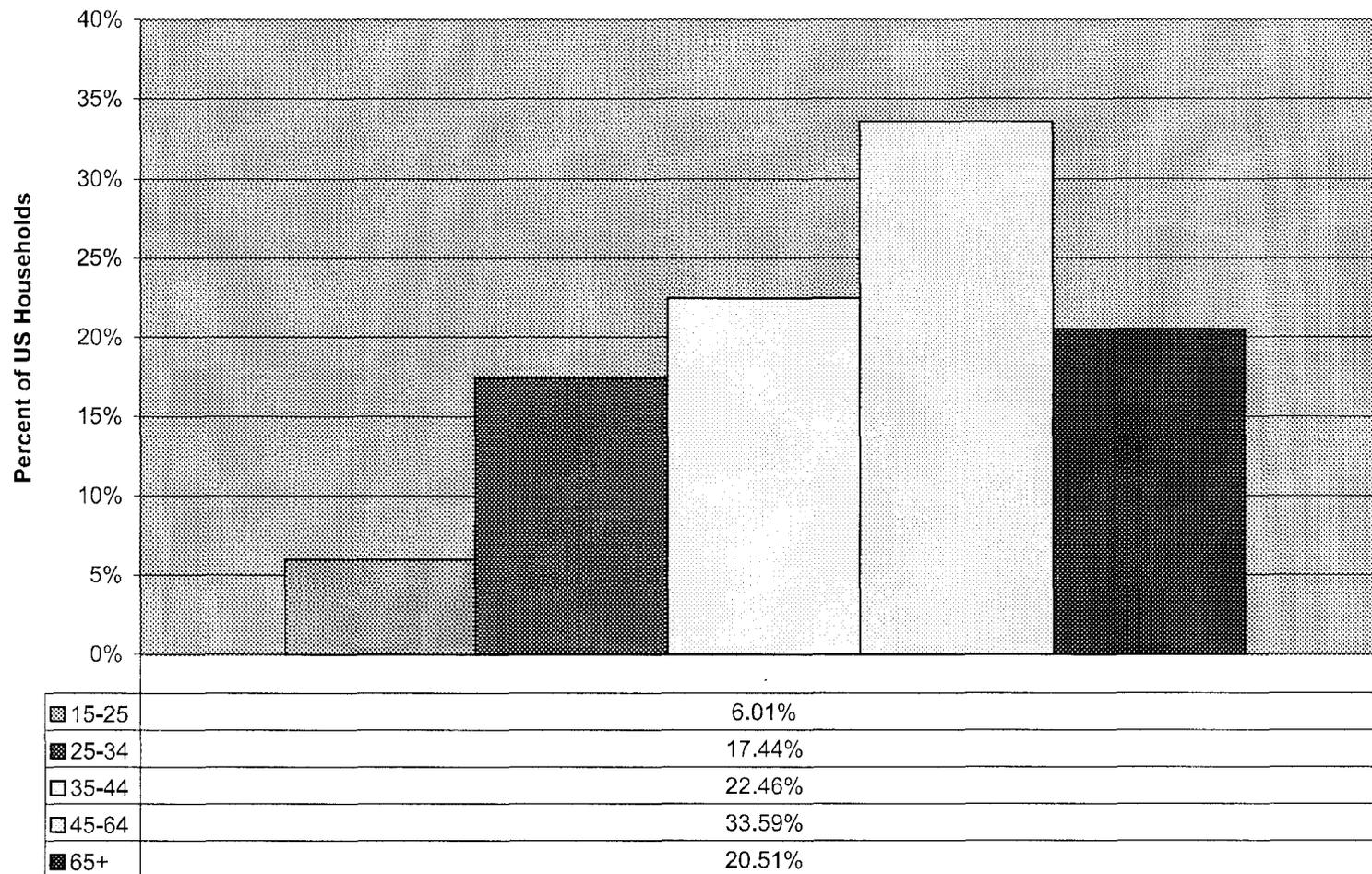


Source: Annual Demographic Survey, March Supplement, Current Population Survey, Bureau of Labor Statistics and the Bureau of the Census. December 2001

Age Distribution by Calling Plan



U.S. Household Distribution by Age



Source: Annual Demographic Survey, March Supplement, Current Population Survey, Bureau of Labor Statistics and the Bureau of the Census. December 2001. Age brackets do not correspond precisely to AT&T data.

Attachment 3:

**Texas Public Utilities Commission
Report on Switched Access Charges
Chapter 1, Recent Changes in Access Charges
December 29, 2000**

(excerpt)

Pat Wood, III
Chairman

Judy Walsh
Commissioner

Brett A. Perlman
Commissioner

W. Lane Lanford
Executive Director



Public Utility Commission of Texas

December 29, 2000

Honorable Members of the Seventy-Seventh Texas Legislature:

We are pleased to submit our Report on Switched Access Charges, as required by Section 58.303 of the Public Utility Regulatory Act (PURA).

This report provides a description and discussion of switched access charges, an important issue in telecommunications. As required by the statute, this report examines whether alternative rate structures for recovery of switched access revenues are in the public interest and competitively neutral, examines whether disparities in rates for switched access service between local exchange companies are in the public interest, and provides our recommendations on the issues reviewed and evaluated.

This is one of three reports on telecommunications issues being provided to the Seventy-Seventh Texas Legislature by our Commission. The companion documents are the Report on the Scope of Competition in Telecommunications, and the Report on the Deployment of Advanced Services in Rural Areas of Texas.

We hope that the information contained in this report will assist you in meeting your public policy objectives. If you need additional information about any issues addressed in the report, please call on us.

Sincerely,

Pat Wood, III
Chairman

Judy W. Walsh
Commissioner

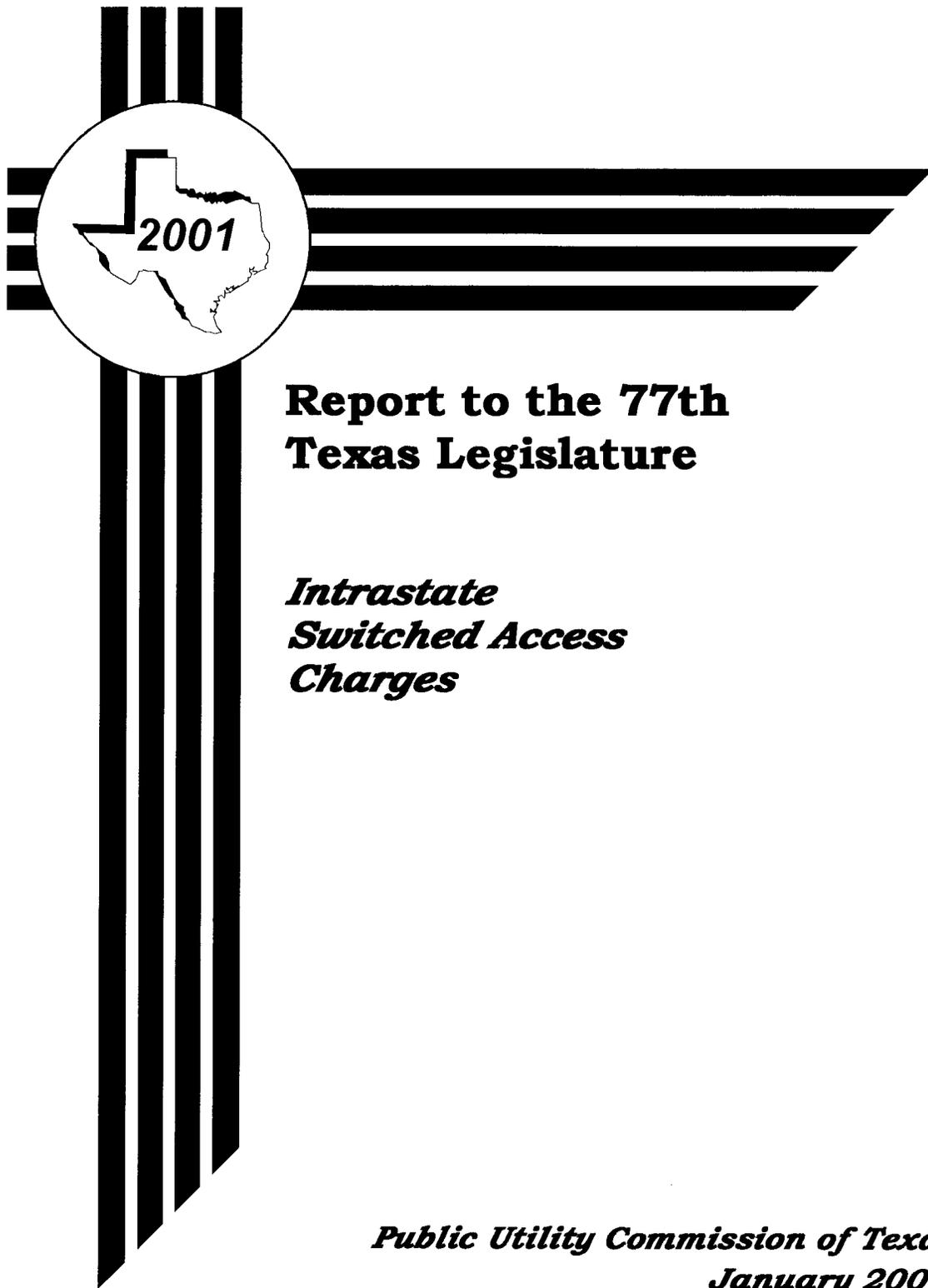
Brett A. Perlman
Commissioner



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**Report to the 77th
Texas Legislature**

***Intrastate
Switched Access
Charges***

***Public Utility Commission of Texas
January 2001***

**REPORT TO THE 77TH TEXAS LEGISLATURE ON
SWITCHED ACCESS CHARGES**

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CHAPTER 1

RECENT CHANGES IN ACCESS CHARGES

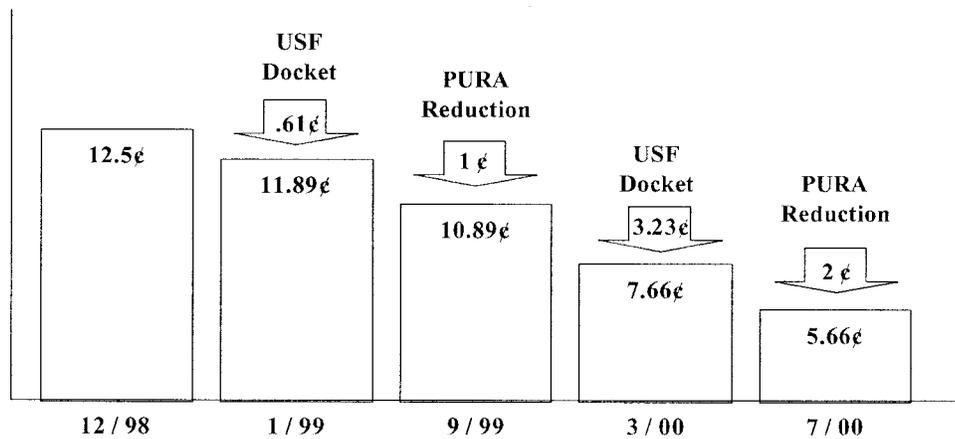
Access charge structures and rates have recently been modified by both the Texas PUC (for in-state calls) and the FCC (for interstate calls). This chapter describes the changes in both jurisdictions to facilitate a better understanding of the actions and their relationship.

Texas Activity on State Switched Access Charges

Switched access reductions prior to 1999 came from either rate case activity or general access reform cases. Because Texas' usage-based switched access rates began in 1984 at over 20 cents per minute, and no flat-rate access charge was employed, the significant reductions from past cases still left intrastate switched access rates very high when compared to interstate rates.

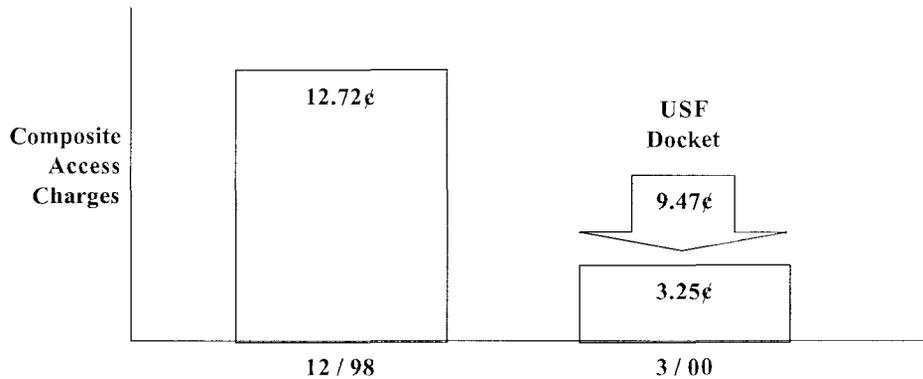
Switched access rates have been significantly reduced in Texas during the last two years as a result of activities related to the Texas Universal Service Fund (TUSF) and PURA requirements. Within Texas, high switched access rates were used to support local telephone companies' high cost and rural infrastructure requirements. But under the directives established by PURA 95, FTA 96, and PURA 99 to reduce subsidies, the PUC investigated and increased the TUSF and made offsetting reductions to switched access charges for the incumbent local telephone companies between December 1998 and March 2000. PURA Section 58.301 required Southwestern Bell Telephone Company (SWBT) to reduce its combined originating and terminating switched access charges by one cent per minute in September 1999 and by an additional two cents per minute in July 2000. The graphic below illustrates recent reductions in SWBT's access charge rates.

Southwestern Bell's Recent Access Rate Reductions
(Composite Originating and Terminating Charges; Excludes Transport Element)



While GTE/Verizon did not have reductions from statutory requirements, the company did experience a significant decrease in access charges as a result of the PUC's TUSF proceeding, as illustrated below.

GTE/Verizon's (Verizon's) Recent Access Rate Reductions
(Composite Originating and Terminating Charges; Excludes Transport Element)



As described more fully in Appendix A, there have been efforts to reduce the level of switched access charges, specifically the usage-sensitive Carrier Common Line (CCL) element. As a result of these efforts, CCL charges have been reduced, and in some cases eliminated, by the local telephone companies. The following table shows the current CCL rates and annualized revenues for the largest incumbent local telephone companies as well as the range of rates and revenues for the small incumbents.

Current Carrier Common Line (CCL) Rates and Revenue For Incumbent Carriers⁴

Incumbent Local Exchange Carrier	Originating CCL Revenue	Originating CCL - Present Rate or Range	Terminating CCL Revenue	Terminating CCL - Present Rate or Range	Total CCL Revenue
Southwestern Bell	\$69,950,000	1.6¢	\$178,450,000	2.7¢	\$248,400,000
GTE/Verizon (incl. Contel)	\$0	0.0	\$0	0.0	\$0
Valor	\$0	0.0	\$0	0.0	\$0
United	\$5,550,000	2.8¢	\$3,150,000	1.4¢	\$8,700,000
Contel	\$0	0.0	\$0	0.0	\$0
Small ILECs	\$8,860,000	0.5¢ - 2.8¢	\$12,700,000	0.9¢ - 7.1¢	\$21,560,000
Total Revenue	\$84,360,000		\$194,300,000		\$278,660,000

⁴ Large telephone company revenue estimates are derived from financial results for 12 months ended 06/30/99 with 5% growth factor for 1yr. Small telephone company revenue estimates are derived from financial results of 12/31/97 with 5% growth factor for 2 yrs.

When evaluating the rates for switched access elements, it is important to note that the charges apply on both the originating end of the connection and the terminating end. Thus, the total charge to the long distance company is the sum of all originating and terminating rate elements. Originating and terminating rates may vary, and the rates may be different for each end of the call, depending on the local telephone company serving the calling or called customer.

The following table shows the composite rate (combined originating and terminating) rates per minute for the CCL and the local switching, but not the transport element of access which could be usage sensitive or flat rated.⁵ The composite rate assumes that a call is originated and terminated within the same local telephone company's territory.

Current Composite Switched Access Charge Rates for Incumbent Carriers

Incumbent Local Exchange Carrier	Composite of Originating and Terminating Switched Access Charges ⁶
Southwestern Bell	5.7¢
GTE/Verizon (incl. Contel)	3.3¢
Valor	3.3¢
Sprint/United	6.7¢
Sprint/Centel	1.5¢
TXU Communications	4.4¢
Century – San Marcos	4.1¢
Fort Bend	4.1¢
Sugarland	4.4¢
Small ILECs	3.4 ¢ - 11.8 ¢

⁵ See Appendix A for a more detailed description of switching and transport elements.

⁶ Rounded, does not include charges for transport.

Recent FCC Actions - Interstate Switched Access

In May 1997, the FCC adopted the Access Charge Reform Order,⁷ applicable to the large incumbent local telephone companies, which established a new common line rate structure in an attempt to align cost recovery with the way costs are incurred. This structure was designed to recover all interstate-allocated common line costs through two flat rate charges: the flat-rate SLC to end users, and a new flat-rate Presubscribed Interexchange Carrier Charge ("PICC") assessed to long distance companies based on their number of presubscribed customers. With this change, the FCC eliminated the originating and/or terminating CCL charges in some instances for the large incumbent local telephone companies and shifted revenue recovery to the PICC. The Order attempted to reduce usage-sensitive access charges through what the FCC described as a market-based approach. In a revenue-neutral manner, the Order separated the previous minute-of-use rate into two parts: a much lower minute-of-use rate and a fixed monthly PICC.

It was the FCC's intent to make these changes without significant rate increases for customers. However, the restructuring failed to reduce long distance rates as planned, primarily because the long distance companies passed the PICC charge directly onto customers' bills in the form of minimum monthly charges, regardless of long distance usage. As a result, many customers' bills did increase, and the FCC began searching for another remedy.

In July 1999, the Coalition for Affordable Local and Long Distance Services ("CALLS") submitted a proposal to the FCC to revise interstate access charges and universal service rules for the larger incumbent local telephone companies.⁸ The FCC adopted a modified version of the CALLS plan⁹ on May 31, 2000. The FCC's rationale for implementing revisions to interstate access rates was that it would lower rates, lessen confusion to customers, and establish a more rational interstate rate structure for the large telephone companies. The FCC reduced the originating and/or terminating interstate CCL for "price cap" incumbent local telephone companies¹⁰ in May 2000. However, all other federally regulated incumbent telephone companies still charge the CCL rate at this time.

The *CALLS Order* eliminated the PICC for residential and small business customers, established a cap on the PICC for multi-line business customers, and reduced originating and terminating CCL charges. The FCC replaced the revenue lost from the

⁷ *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Red 15982 (1997) (*Access Charge Reform Order*).

⁸ CALLS consists of AT&T, Bell Atlantic, BellSouth, GTE, SBC, and Sprint.

⁹ Sixth Report and Order in CC Dockets 96-262 and 94-1, Report and Order in CC Docket No. 99-249 and Eleventh Report and Order in CC Docket No. 96-45, May 31, 2000 (*CALLS Order*).

¹⁰ Rate-of-return regulation is designed to control the profits an incumbent local carrier may earn from access service, whereas the FCC's price cap regulation plan focuses primarily on the prices that such a carrier may charge and the revenues it may generate from interstate access services.

reduced or eliminated charges with an increase in the interstate SLC¹¹ as well as funding from a new \$650 million federal USF program. Therefore, customers continue to pay for a portion of local loop costs through their interstate SLC charges. The FCC has scheduled future review of the switched access revisions and has established a phase-in for the SLC increases. As an additional part of the *CALLS Order*, the FCC increased its support for Lifeline and Link-Up services, targeted at low-income individuals. The interstate switched access reforms in the *CALLS Order* will be required of price cap LECs, including Southwestern Bell and Verizon (formerly GTE SW), for a five-year term. At the end of the five years, the FCC will conduct a proceeding to determine whether to partially or fully deregulate price cap LECs, and to assess the adequacy of the interstate access universal service support mechanism. A version of access charge reform for smaller and rural LECs is currently being evaluated as well.¹²

¹¹ The FCC raised the interstate SLC from \$3.50 to \$4.35 monthly for single line residence and business access lines, and phases in additional increases to the monthly rates for residence and business access lines over a five-year period.

¹² For a complete copy of the proposal, known as the MAG plan, as submitted to the FCC on October 20, 2000, see: www.opastco.org or www.nfca.org/mag.html